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# Building Productive Capacities for Trade Competitiveness: Economic Partnership Agreements (EPAs) and UNIDO's Response

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# ABBREVIATIONS

| | |
|---|---|
| ACP | African, Caribbean and Pacific |
| ADEPME | Agence de Développement et d'Encadrement des Petites et Moyennes Entreprises |
| AFD | Agence Française de Développement |
| AGOA | African Growth and Opportunity Act |
| APCI | African Productive Capacity Initiative |
| CARICOM | Caribbean Community and Common Market |
| CEMAC | Central African Economic and Monetary Community |
| CET | Common External Tariff |
| CGE | Computable General Equilibrium |
| COMESA | Common Market for Eastern and Southern Africa |
| CSR | Corporate Social Responsibility |
| CU | Customs Union |
| DG | Director General |
| EAC | East African Community |
| EBA | Everything but Arms |
| EC | European Commission |
| ECA | Economic Commission for Africa |
| ECOWAS | Economic Community Of West African States |
| EDF | European Development Fund |
| EPA | Economic Partnership Agreement |
| ESA | East South Africa |
| EU | European Union |
| FDI | Foreign Direct Investments |
| FTA | Free Trade Agreement |
| GATT | General Agreement on Tariffs and Trade |
| GDP | Gross Domestic Product |
| GSP | Generalized System of Preferences |
| GTZ | Deutsche Gesellschaft für Technische Zusammenarbeit |
| HACCP | Hazard Analysis and Critical Control Point |
| IMF | International Monetary Fund |
| ISO | International Organization of Standardization |
| LDC | Least-Developed Country |
| MDG | Millennium Development Goal |
| MEDA | Euro - Mediterranean Partnership |
| MFN | Most Favoured Nation |
| MNC | Multinational Corporations |
| MSE | Micro and Small Enterprises |
| MSME | Micro, Small and Medium Enterprises |
| MVA | Manufacturing Value Added |
| NEPAD | New Partnership for Africa's Development |
| NGOs | Non-governmental organizations |
| NSB | National Standards Body |
| ODA | Official Development Assistance |
| OECD | Organisation for Economic Co-operation and Development |
| QI | Quality Infrastructure |
| RECs | Regional Economic Communities |
| RIPs | Regional Indicative Programmes |
| RoO | Rules of Origin |
| RPTF | Regional Preparatory Task Force |

| | |
|---|---|
| RTAs | Regional Trade Agreements |
| SA | Social Accountability |
| SAARC | South Asian Association for Regional Cooperation |
| SACU | The Southern African Customs Union |
| SADC | Southern African Development Community |
| SIDS | Small Island Developing States |
| SIECA | Central American Integration System |
| SMEs | Small and medium enterprises |
| SPS | Sanitary and Phytosanitary Standards |
| SSA | Sub-Saharan Africa |
| TBT | Technical Barriers to Trade |
| TRTA | Trade Related Technical Assistance |
| TTCs | Trade Transaction Costs |
| UEMOA | West African Economic and Monetary Union |
| UNCTAD | United Nations Conference on Trade And Development |
| UNDP | United Nations Development Programme |
| UNIDO | United Nations Industrial Development Organization |
| VAT | Value Added Tax |
| WTO | World Trade Organization |

# EXECUTIVE SUMMARY

The current background paper has been prepared for the High-level Panel "Building productive capacities for trade competitiveness: Economic Partnership Agreements (EPAs)", taking place during the 12th Session of the UNIDO General Conference. It intends to provide extensive background information and discussion material on the EU-ACP Economic Partnership Agreements.

It is divided into three parts:

**Part I** includes an overview of the EU-ACP economic and trade cooperation including a situation analysis of the economic position of the ACP region. Special emphasis is put on the development component and the Aid for Trade initiatives. **Part II** entails a discussion of the opportunities and challenges of EPAs and proposes several adjustment measures on how to foster regional integration, strengthen productive and trade capacities and mitigate the negative effects from trade liberalization of industrial products. **Part III** presents UNIDO's response to EPAs, including its approach and the experience of past industrial upgrading and modernization programmes.

Poverty reduction through building stronger economies, regional integration and investment promotion are essential parts of the WTO-compatible Economic Partnership Agreements the EU negotiated over the past five years with six African, Caribbean and Pacific (ACP) regions in parallel. The trade chapters of the 2000 Cotonou agreement were discriminating other developing countries and have to be replaced by the end of 2007.

The increasing economic marginalization of most ACP countries has to be reverted in order to integrate them into the world economy. The EU strives to achieve this by gradually establishing a free trade area between the two regions, immediately giving full market access to ACP countries[1], which should increase the quantity and diversity of ACPs trade and thereby promoting their sustainable development.

It is evident that the EU and ACP differ in terms of economic development and external trade, especially in the industrial sector. The 27 EU countries have a combined GDP of € 10,900 billion while the potential signatories of EPAs achieve only € 440 billion. After more than thirty years of preferential access to Europe's markets, ACP countries predominantly export just a few basic commodities whose non-oil prices are in long-term decline. In order to be an instrument for development, the EU and ACP have to seize opportunities and tackle challenges connected to reciprocal trade liberalization, including regional integration, supply-side constraints, non-tariff barriers, trade facilitation and foreign direct investments (FDIs).

Regional integration is a means of achieving industrialization and modernization by encouraging trade, attracting investments, and securing economies of scale. But high tariffs among ACP countries continue to constrain the prospects for expanding South-South trade. Intra-regional trade accounts only for 11% of total ACP trade at the moment. Opportunities in the framework of EPAs arise from SME cluster development and better utilization of production linkages within a region. Pooling of resources is key to ensure economic growth.

Supply-side constraints have hampered the expansion of production and trade until now. However, manufacturing has the potential to lift people out of poverty by creating

[1] With the exception of rice and sugar

productive employment opportunities. For this purpose, industrialization has to be promoted by strengthening productive and trade capacities and increasing productivity, diversification and value addition. Improving the competitiveness of products will also ensure benefits from the improved market access to the EU. Accompanying measures are needed to achieve a dynamic, innovative and growth oriented private sector. If not enough will be done before the end of the EPA transitional period, a serious threat to ACP livelihoods will arise when EU enterprises directly compete with domestically produced goods. The nomination of sensitive sectors will help to protect nascent industries and to prevent deindustrialization.

Non-tariff barriers should be removed and regulations and procedures simplified. However, if enterprises in ACP countries do not want to loose market access to the EU, they have to meet the requirements of the WTO SPS and TBT Agreements. Products must meet quality standards and be safe and reliable. ACP countries should be helped to develop SPS/TBT strategies. A quality infrastructure, with efficient inspection, testing, certification and accreditation mechanisms, has to be established.

The EU supports the implementation of EPAs through trade-related assistance, coming from the 10th European Development Fund (€22,7 billion for 2008-2013) and upscaled Aid for Trade funds to € 2 billion from 2010 on (whereas 50% are targeted to ACP countries). The Funds should be used for trade facilitation/export promotion support, production and employment adjustment assistance, fiscal adjustment support, human resources development and productivity enhancement support. Focused on cooperation in industrial development and competitiveness, it should be envisaged to establish, develop, restructure and modernize ACP countries' industries and establish an environment favourable to the development of private enterprises.

UNIDO has a long track record of developing supply capacity. In recent years, UNIDO has implemented/is implementing pilot programmes in the context of restructuring, upgrading and industrial competitiveness in African regions, such as North Africa (Tunisia, Algeria, Morocco, Egypt, Syria), West Africa (Senegal, Ghana, and UEMOA), East Africa (East African Community quality programme) and Central Africa. Other Trade Capacity Building programmes have also been implemented in the Arab region, in Asia and in Latin America.

Given its recognized expertise and successful experience, UNIDO received requests from the 6 ACP secretariats involved in the EPA negotiations to start with the formulation of industrial upgrading and modernization programmes. These programmes will assist ACP countries to maximize the benefits from EPA opportunities and to prepare economies and industries to face EPA challenges.

The assistance of UNIDO through the industrial upgrading and modernization programmes aims at enhancing and supporting competitiveness of productive sectors, integration in global trade and growth at the industrial and enterprise levels; preparing for international competition and improving productivity, quality and increasing export capacities.

This includes improvement of the institutional and policy environment; upgrading and strengthening technical support institutions, enhancing capacities of quality infrastructure; and upgrading pilot enterprises selected from priority sectors.

# PART I: OVERVIEW OF EU-ACP ECONOMIC AND TRADE COOPERATION

> *"[…] the precepts of regionalization, envisioned in the six EPA negotiated frameworks, are bound to profoundly affect the socio-political and economic dimensions of ACP countries. […] The implementation phase, quite possibly the more difficult component, requires diligence and expertise to ensure that the transition - positive or negative - is handled as best as we possibly can."*
>
> **Sir John Kaputin, Secretary General of the ACP Group[2]**

## 1. What are Economic Partnership Agreements?

### HISTORY

The EU and the ACP countries have a long lasting relationship, first formalized by the Yaoundé Convention in 1963. The membership of the association agreement was extended in 1975 in the Lomé Convention, which included an agreement for preferential, non-reciprocal tariffs to the ACPs. The four Lomé Conventions, signed every 5 years, focused on areas such as development aid, unilateral liberalization of trade, promote and expedite the economic, cultural and social development of the ACP states, promote diversification, human rights, democracy and good governance.

After the creation of the World Trade Organization (WTO) in 1995, there was a pressure to re-negotiate the agreements. This led to the signature of the *Cotonou Agreement* the 23 June 2000, agreed for a total of 20 years. The main objective of this agreement is to "***reduce and eventually eradicate poverty, consistent with the objectives of sustainable development and the gradual integration of the ACP countries into the world economy"[3].***

The objectives of the Economic and Trade Cooperation in Cotonou are to foster the "*smooth and gradual integration of the ACP States into the world economy, […] thereby promoting their sustainable development and contributing to poverty eradication in the ACP countries*" and at "*enhancing the production, supply and trading capacity of the ACP countries as well as their capacity to attract investment*" by "*creating a new trading dynamic between the Parties" in order to enable "the ACP States to manage the challenges of globalization […] thereby facilitating their transition to the liberalized global economy*"[4].

This should occur by means of replacing the trade chapters of the Cotonou Agreement and negotiating **Economic Partnership Agreements (EPAs)**.

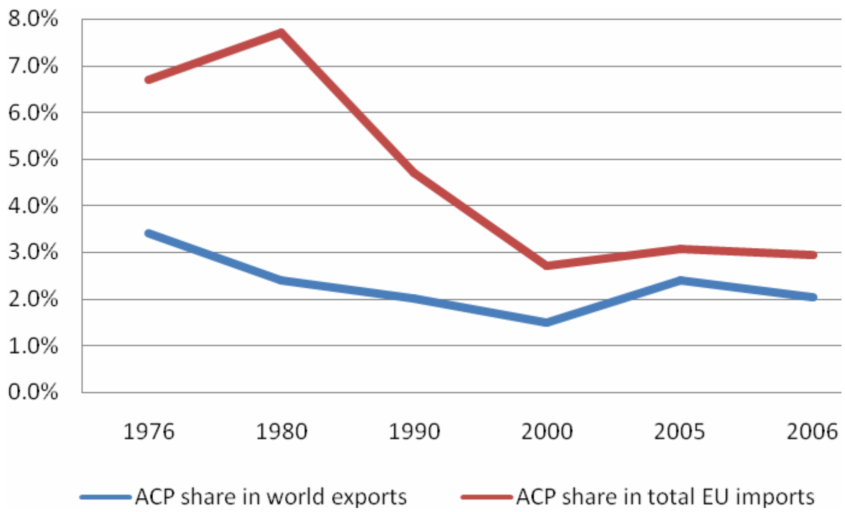
Why has this seen to be necessary?

[2] Welcome Speech „Legal Experts Meeting on the Economic Partnership Agreements", 9 October 2007, Brussels.

[3] Art. 1 of the Cotonou Agreement

[4] Art. 34 (1) - (3) of the Cotonou Agreement

**<u>Figure 1:</u> Economic marginalization of ACP countries**




***Source:*** *Data Eurostat*

After 25 years of preferential access to the European market the ACP states did not manage to increase their export shares to the EU and the rest of the world. ACPs share in world exports fell from 3.4% in 1976 to 2.04% in 2006 while the share of the ACP in total EC imports fell from 6.7% in 1976 to 2.95% in 2006 despite unilateral and preferential market access[5] (see Figure 1).

The Lomé Conventions were also incompatible with WTO rules and discriminated against other developing countries. Article 1 of the General Agreement on Tariffs and Trade (GATT) concerning the general treatment of the Most Favoured Nation (MFN) clause says that "any advantage, favour, privilege or immunity granted by any contracting party to any product originating in or destined for any other country shall be accorded immediately and unconditionally to the like product originating in or destined for the territories of all other contracting parties."

The EU is allowed to give developing countries non-reciprocal trade preferences but the so-called "Enabling Clause" does not allow for discrimination between them, with exception to least-developed countries (LDCs).
The current preferential market access is based on a WTO waiver obtained at the Doha Ministerial Conference on November 14th 2001, which, however, runs out at the end of 2007, requiring both parties to have put in place a WTO-compatible alternative. A further extension is not seen as likely, since other WTO members, especially the developing and emerging economies, are disadvantaged with the current situation and not willing to accept another waiver.

5 Eurostat, 2007 and World Bank, 2007

## ECONOMIC PARTNERSHIP AGREEMENTS

> *"Economic Partnership Agreements (EPAs) respond to the need for change: they take a new, more comprehensive approach, tackle all barriers to trade, mostly through re-enforcing regional integration and addressing supply-side constraints, and form secure WTO-compatible arrangements".*
>
> **European Commission**[6]

Economic Partnership Agreements (EPAs) are the trade and development agreements the European Union is currently negotiating in parallel with six African, Caribbean and Pacific (ACP) regions (West Africa, East and Southern Africa (ESA), Central Africa, Southern Africa, the Caribbean and the Pacific). Full agreements are expected to cover trade in products (agricultural and industrial) as well as trade in services, economic and development cooperation, development finance cooperation, intellectual property rights, customs regimes, government procurement, investment and private sector development support, standards, technical regulations and conformity assessment, trade facilitation and competition policy.

EPAs will lead to free-trade areas (FTAs), which will progressively abolish "substantially all tariffs" between the Parties and will therefore conform to Article XXIV of the GATT. While the EU will completely open up its market from day one[7], ACP will progressively open regionally to each other, and then on a highly asymmetrical basis, to the EU. Former FTAs, for example between the EU and Morocco or South Africa, had a transitional period of 12 years. It is expected that substantially all trade will result for the six regions to liberalize 80% or more of the total value of trade after a transitional period of up to 15 years. ACP will be able to exclude sensitive sectors and delay liberalisation to allow time for growing industries to adapt to change.

EPAs are based on four principles:

- Partnership: EPAs imply duties and privileges on both sides. The EU will remove non-trade barriers while ACP have to implement appropriate policies to tackle supply-side constraints and to reduce transaction costs.
- South-south integration: Regional integration lies at the heart of the agreement. If ACP regions are not able to reduce tariffs between themselves, facilitate trade, resolve the problems arising from overlapping membership and pool together their resources, it is likely that there will be no integration of ACP countries into the world economy. The efforts undertaken in the last years have to continue on a meaningful basis and be reinforced. Special attention should be drawn to intra-regional trade diversion effects after complete liberalization.
- Development: EPAs are instruments for development. Out of the 78 ACP countries, 41 are classified as Least Developed Countries (LDCs). It has been stressed again and again by all parties[8], that the "development dimension" is central to EPAs in order to eventually achieve the objective of the Cotonou agreement: eradication of poverty.
- WTO-compatible: EPAs will build on rules of the WTO, and, if possible, go beyond the WTO. They will define bilateral trade relations intended to

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6 EC (2003). "EPAs: Means and Objectives", http://trade.ec.europa.eu/doclib/docs/2003/december/tradoc_115007.pdf

7 With transitional periods for rice and sugar

8 e.g. European Parliament, 2007 Report on EPAs (2004/2246(INI)), Final A6-0084/2007, Committee on International Trade, Rapporteur: Robert Sturdy, 27.3.2007.

alleviate all practical barriers to trade between the two regions. Furthermore the negotiations are strengthening ACP capacities for further multilateral trade talks.

The main objectives can be summarized as follows:

- Create "North-South-South" agreements linking the world's largest customs union, the EU, with existing and upcoming customs unions in the South.
- The attainment of sustainable development, the elimination of poverty as well as a smooth and gradual integration into the world economy.
- The achievement of sustainable economic growth, expansion and modernization of private sector, lowering unemployment levels as well as better access to productive resources.
- Achieve increased value-added of merchandise products to lower level of primary products, especially for agricultural products. Promote industrialization by strengthening productive and trade capacity.
- Develop adequate infrastructure and tackle legal and administrative problems related to the export of goods and services to the EU. Further reduce non-tariff barriers.

However, most regions and countries do not see themselves in a position to sign full comprehensive EPAs by the end of 2007, with the exception of the Caribbean. Therefore, it is likely that goods-mainly interim agreements will be signed with ESA, Pacific and Southern Africa. Negotiations will continue in order to complete a comprehensive EPA in 2008. For Central and West Africa the situation remains difficult.

## 2. Regional Groupings

There are 76 ACP countries negotiating EPAs[9], divided into 6 regional groupings (see Table 1). Four of these groupings are in Sub-Saharan Africa, one in the Caribbean and one in Pacific. This division was not only made to save time and harmonize outcomes within a region but also because there are too many, sometimes too small ACP countries who do not have enough negotiating capacities and are relatively weak in terms of their trading positions with the EU and the rest of the world.

Different countries face different development challenges. More than half of ACP are LDCs. Moreover the multitude of Small Island Development States (SIDS), landlocked countries and heavily indebted poor countries (HIPC) underlines the reason for a suboptimal development situation in the region. Therefore, EPAs take into consideration the level of development of each country and their socio-economic impact on them.

[9] South Africa is negotiating EPAs with SADC but already signed a FTA with the EU in 1999. Somalia and Timor-Leste, while being ACP countries are not negotiating EPAs.

**<u>Table 1:</u> Country groupings for EPA negotiations**

| | West Africa ECOWAS+ Mauritania | Central Africa CEMAC+ STP | East South Africa ESA | Southern Africa "SADC group" | Caribbean | Pacific |
|---|---|---|---|---|---|---|
| 1 | *Benin* | Cameroon | *Burundi* | *Angola* | Antigua, Barb | Cook Is. |
| 2 | *Burkina Faso* | *Central Africa* | *Comoros* | Botswana | Bahamas | Fed. Micron. |
| 3 | *Cape Verde* | *Chad* | *Djibouti* | *Lesotho* | Barbados | Fiji |
| 4 | *Gambia* | Congo | *Eritrea* | *Mozambique* | Belize | *Kiribati* |
| 5 | Ghana | *Congo (D.R.)* | *Ethiopia* | Namibia | Dominica | Marshall Is. |
| 6 | *Guinea* | *Equat. Guinea* | Kenya | Swaziland | Dom. Rep. | Nauru |
| 7 | *Guinea Bissao* | Gabon | *Malawi* | *Tanzania* | Grenada | Niue |
| 8 | Ivory Coast | *S.Tome, Princ.* | Mauritius | South Africa | Guyana | Palau |
| 9 | *Liberia* | | *Madagascar* | | *Haiti* | Papua N. G. |
| 10 | *Mali* | | *Rwanda* | | Jamaica | *Samoa* |
| 11 | *Mauritania* | | Seychelles | | St Lucia | *Solomon Is.* |
| 12 | *Niger* | | *Sudan* | | St Vincent | Tonga |
| 13 | Nigeria | | *Uganda* | | St. Ch. & Nevis | *Tuvalu* |
| 14 | *Senegal* | | *Zambia* | | Surinam | *Vanuatu* |
| 15 | *Sierra Leone* | | Zimbabwe | | Trinidad & Tob. | |
| 16 | *Togo* | | | | | |

***Source:*** *European Commission, LDCs in Italic*

## 3. Situation analysis: Economic Position of ACPs

The European Union and the African, Caribbean and Pacific countries do not only vary in the number of countries, the population size and the surface area but more importantly regarding EPAs, in economic terms.

The EU has a Gross Domestic Product (GDP) 25 times higher than the ACP, with a per capita GDP of more than 37 times higher. Single negotiating regions achieve only between 0.1 and 1.2 per cent of EU's GDP. The demographic, economic and social differences between ACP and EU are depicted at a glance in Table 2 below.

The most important trade partners for the EU can be found in the USA, Russia and the emerging market China, whereas, ACPs share for import and export is only 3%.

For the ACP however, the EU is the most important import partner and the second largest destination in terms of export value. The EU represents 38 percent of the world trade while ACP share is only 2%. Other important partners are the USA and increasingly China.

Median Human Development in ACP countries is low, reflected by the fact that within the ACP regions secondary and tertiary education levels are generally low as well as government's health expenditure, leading to a low life expectancy.

**<u>Table 2:</u> Demographic, Economic and Social indicators for the EU and ACP**

| | European Union | Africa, Caribbean and Pacific |
|---|---|---|
| Member countries | 27 countries[10] | 78 countries[11] |
| Population (1st January 2005) | 489 million (a) | 728.5 million (excluded SA) (b) |
| Surface area | 4 million km$^2$ (c) | 25 million km$^2$ (b) |
| GDP (2006) | € 10917 billion (a)<br>€ 22.325 per capita (a) | € 435 billion (b)<br>€ 597 per capita (b) |
| Total Export (2006) (d)<br>Share in world trade (2006)<br>Average growth rate (2000-05)<br>Percentage of Intra-trade (2005) | $ 4.538 billion (EU-25)<br>37,87%<br>11,9%<br>66,5% | $ 246 billion<br>2,06%<br>15,1%<br>11% |
| Total Trade within the two regions (2006) (b) | EU-25 exports to ACP:<br>€ 34 billion | EU-25 imports from ACP:<br>€ 39.9 billion |
| Major export partners (2006) (b) | USA (23%)<br>Switzerland (7,4%)<br>Russia (6,2%), China (5,4%)<br>... **ACP Countries (2,9%)** | USA (33,8%)<br>**EU (22,7%)**<br>China (11,3%)<br>Japan (3,3) |
| Major import partners (2006) (b) | China (14,2%)<br>USA (13,1%)<br>Russia (10,1)<br>… **ACP Countries (3,0%)** | **EU (24,7%)**<br>USA (12,5%)<br>China (8,5%)<br>Korea (4,9%) |
| Foreign Direct Investment (2005) (d) | Inward flows: $ 422 billion<br>Outward flows: $ 554 billion | Inward flows: $ 24 billion<br>Outward flows: $ 0,85 billion |
| UNDP Human Development Index (2004) (e) | High | 8 countries high[12]<br>25 countries medium,<br>remaining low |
| Least Developed Countries (LDC) | None | 41<br>(34 in Africa, six in the Pacific, one in the Caribbean) |

***Sources:*** *(a) Europe in figures, Eurostat yearbook 2006-07, 20 February 2007.*
*(b) EUROSTAT or World Bank, as quoted in DG-TRADE, Fiche Pays ACP, 07 August 2007.*
*(c) Key facts about Europe and the Europeans, European Commission.*
*(d) UNCTAD Handbook of Statistics 2006-07*
*(e) United Nations Development Programme (UNDP), Human Development report 2006*

Over the past four years real GDP growth in ACP was constantly over six per cent, resulting from rising productivity, domestic investment and government consumption. The latter has been possible through debt relief and higher oil revenues. But still more than half of ACP states are LDCs, reflected in a low GDP per capita. It fluctuates between regions and between countries. At constant prices from 2000, in 2006 it varies between $ 93 in Dem. Rep. Congo and almost $ 16000 in the Bahamas. Twelve and eleven LDCs are in West African and ESA, respectively, resulting in the lowest median. A comparison of GDP per capita in the RECs can be found in Figure 1 in the Annex.

[10] 12 new members since the beginning of EPA negotiations

[11] Including Somalia and Timor-Leste who are not negotiating/signing EPAs

[12] Barbados, Seychelles, St. Kitt and Nevis, Bahamas, Tonga, Trinidad and Tobago, Antigua and Barbuda, Mauritius (with decreasing scores)

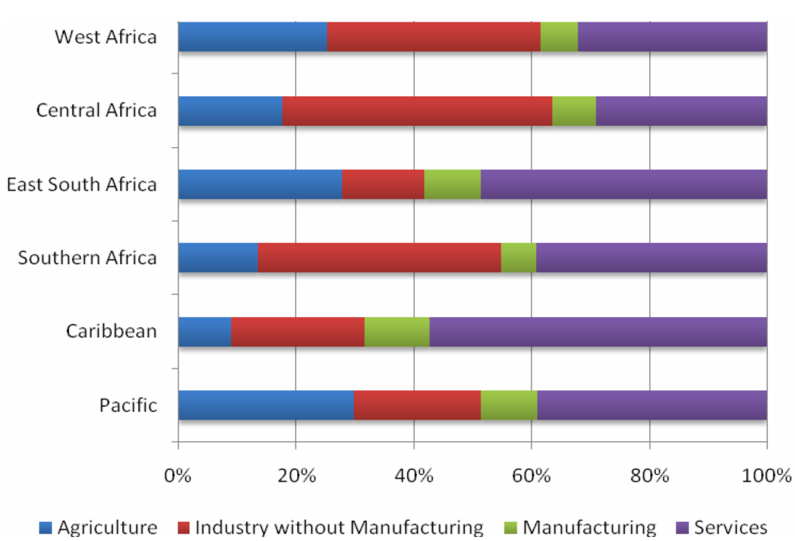
## AGRICULTURE, INDUSTRIES, MANUFACTURING AND SERVICES

The composition of the GDP varies from region to region and from country to country (Figure 2). Many countries continue to be dominated by **agriculture** that can account up to 60 percent of GDP, whereas the population working in that sector can even reach 90 percent. Most of the employment is still in the subsistence sector, as, in general, very little value addition and processing of agricultural products is taking place in the region. The Pacific and Eastern Southern African region have the biggest share of GDP in the primary sector. The median is at 17%, meaning that half of the ACP countries have a higher percentage, the other half a lower one.

The **service** sector is the most important regarding GDP composition. In the Caribbean it surpasses the 50% by far, in ESA it almost reaches them. In some countries within the EPA RECs even 80 percent of GDP comes from the tertiary sector (e.g. Barbados, Djibouti, Palau). The median is at 49%. The reason for the high figures could also be a result of a lack of data in some countries. Every dollar of GDP not attributable to the agricultural and industrial sector will be listed in the service sector, of course resulting in an overestimation.

Africa is the least developed region of the world in terms of industrialization and the Caribbean and Pacific are generally not very industrially developed either. The ACP account for a negligible share of global industrial output. **Industry** (without manufacturing) is especially pronounced in West Africa, Central Africa and Southern Africa, resulting from petroleum oils and diamonds. It ranges between 2,7% in Zimbabwe and 95% in Equatorial Guinea, whereas the median lies at 13 percent. Industrialization is a critical engine of economic growth and development, shown in the linkage between them. The last decades have shown that rapid growth in the developing world has been consistently linked with diversification of production into manufacturing and modern services.

**<u>Figure 2:</u> Share of GDP of different sectors**




***Source:*** *Own calculations based on African Development Bank data.*

The ACP countries are also marginalized in global **manufacturing**. Only ten ACP countries have already achieved an upper industrial stage with ratios above 15% in GDP. The share of manufacturing value-added (MVA) reaches little more than 6 percent in average in West Africa and Southern Africa, in ESA, Pacific and Caribbean more than 9 percent. At the country level, it varies between 0,1% in Equatorial Guinea and 36,6% in Swaziland. The median is at 7,5%.

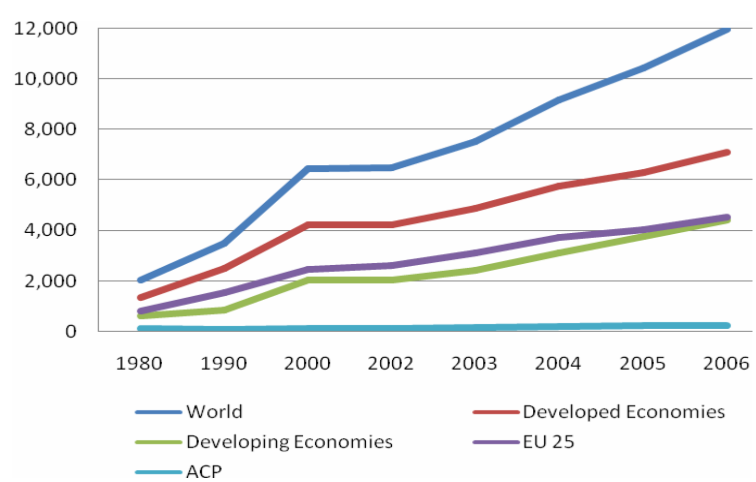
Even though, the output of the sector is heavily concentrated on low technology products such as food, textiles, clothing, footwear, etc. The majority of ACP countries are yet to be involved in any significant sense in the medium- and high-technology segments of global manufacturing that have been characterized by dynamism and rapid growth in recent years.

Manufacturing growth failed to keep pace with overall economic growth in ACP countries. For this part of industries the median growth in all regions was at 3 percent annually over the last five years, with peaks of even 60% in Equatorial Guinea. Other countries with 7% increases or more in the same period include Mozambique, Nigeria, Tanzania and Togo in SSA and Suriname and Trinidad & Tobago in the Caribbean. However, in some states manufacturing as a share of GDP even declined, maximum -11% annually in Zimbabwe over the last six years[13]. Details for the share of manufacturing/GDP in ACP countries can be found in Table 1 of the Annex.

The share of MVA of SSA remained stagnant at around one per cent within developing countries, and only 0,25% of world industrial production. While the output share of SSA is modest, its value has increased by around one third since 1990[14].

The biggest ACP countries regarding total GDP at current prices in 2006 are Nigeria, Angola and Sudan. Those countries have discovered huge oil fields in the last years,

**<u>Figure 3:</u> Development of ACP and EU exports in comparison to world exports**




***Source:*** *UNCTAD, Handbook of Statistics 2006-07*

13 Other countries between 2001 and 2006 (annually): Ivory Coast (-2%), Seychelles (-4%) in SSA. Papua New Guinea (-3%), Vanuatu (-7%) in Pacific and Grenada (-3%) in the Caribbean.

14 UNIDO Industrial Development Report 2005

resulting in a structural change in industries, but not in manufacturing. Their growth is mainly attributable to a number of exogenous factors such as high commodity prices, debt relief and strong world demand. Relatively high percentages in manufacturing can however be found in Cameroon, Ivory Coast, Dominican Republic and Kenya (More details in Table 2 in the Annex).

While the ACP countries account for approximately 9% of the world population, its exports in the world accounted only for 2%. The EU made up almost 38%. These percentages correspond to $ 246 billion and $ 4.538 billion of global exports respectively (Figure 3). Both the EU and ACP had sustainable export growth rates since 2000, arriving at annually 11,9% and 15.1% respectively.

ACPs share of manufactured exports in total merchandise exports varies again considerably between countries. The average is 29% while the median being 20, ranging from 0,1% in Sudan to 96% in St. Kitts and Nevis. These exports are mainly low-tech products, mostly semi-processed light consumer goods. Furthermore, medium- and high-technology exports have declining shares. ACP countries have to undertake big efforts, like improving their infrastructure and seize scale economies, combined with political commitment to scale up their share in manufacturing, in order to achieve long-term sustainable economic growth. This is especially important at a time when manufactures account for 75% of global trade.

## EU-ACP TRADE

Focusing on EU-ACP trade, in 2006 European Union imports from ACP countries amounted to almost € 40 billion, corresponding to 2,95% of total EU imports (Table 3). Primary products made up an impressive 78,8%, of which 24% in agricultural products and 43% in energy. Manufactured products amounted to 20 percent of total imports from ACP countries. This equals 1 percent of total EU manufacturing imports. Between 2002 and 2006, imports rose by more than € 9 billion, almost exclusively thanks to energy-related products.

**<u>Table 3:</u> European Union imports from ACP countries in 2006**

| European Union, Imports from ACP | 2006 | % | Share of total EU imports |
|---|---|---|---|
| Total | 39.851 | 100,0% | 2,95% |
| | | | |
| Primary Products | 31.392 | 78,8% | 6,21% |
| *of which:* | | | |
| Agricultural products | 10.120 | 25,4% | 11,10% |
| Energy | 17.339 | 43,5% | 5,19% |
| | | | |
| Manufacturing Products | 8.129 | 20,4% | 1,0% |
| *of which:* | | | |
| Machinery | 300 | 0,8% | 0,10% |
| Transport equipment | 1.933 | 4,9% | 2,0% |
| Chemicals | 615 | 1,5% | 57,0% |
| Textiles and clothes | 831 | 2,1% | 1,01% |
| Beverages and Tobacco | 615 | 1,5% | 10,2% |
| Office/telecom. Equipm. | 113 | 0,06% | 0,3% |

***Source:*** *Eurostat (COMEXT, Statistical regime 4)*

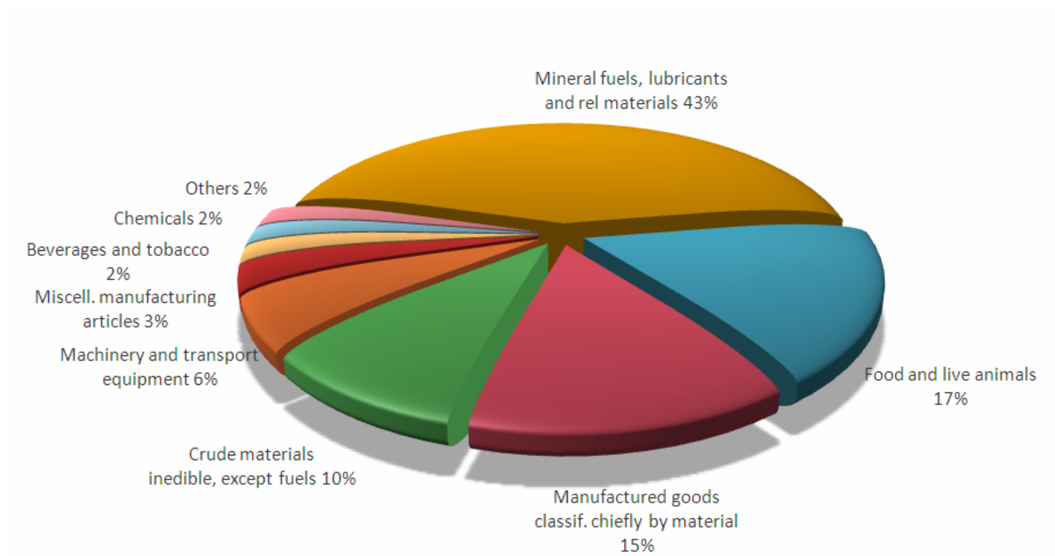
In Figure 4 below, the main imported ACP products are depicted graphically. Food and live animals consisted mainly of cocoa beans, sugar, coffee, fish and bananas. Manufacturing products were transport equipment, textiles and clothes, beverages and tobacco and machinery. Spain, France and the United Kingdom are the EU countries that import most from ACP countries.

Several ACP countries have been able to increase their export quantities to the EU during the last decades, facilitated by the Yaoundé and Lomé conventions. But even though, this was dependent on a few basic commodities, whose non-oil prices are in long-term decline, and a handful ACP countries. In 2006, 6 countries represented over 50% of total EU imports from ACP, these being Nigeria (26% of ACP exports), Cameroon (7%), Angola (5%), Côte d'Ivoire (6%), Equatorial Guinea (4%) and Ghana (3%)[15].

The destination shares of Sub-Saharan African (SSA) exports, including 4 out of the 6 EPA regional groupings, changed during the last decade. In 2001, the EU was by far the first largest recipient of their exports, receiving almost 35 per cent of total SSA exports, while in 2005 it decreased to 25 percent[16]. Asia's share has been rising during the last years as well as exports going to the United States. This is due to increasing exports of fuels and textiles to the U.S., and because of implementation of the AGOA scheme.

The social, economic and political gap between these two regions offer challenges to ACP countries, when trade should be liberalized vis-à-vis the European Union. On the other side, the region must take advantage of new opportunities offered by EPAs and globalization by increasing capacities of enterprises, putting in place policies for upgrading, developing human resources, strengthening capacities for innovation, and, by accepting the facts of industrialization. The agreements offer a chance to integrate the region into the world market and reduce poverty.

**<u>Figure 4:</u> Imports from ACP (without SA)**




***Source:*** *Eurostat, (Comext, Statistical regime 4)*

15 Source: Eurostat 2007

16 IMF, Regional Economic Outlook: Sub Sahara Africa, April 2007

# 4. Development component and Aid for Trade

## PRO-DEVELOPMENT

The EC states that "EPAs are above all instruments for development"[17]. Promoting sustainable development and contributing to poverty eradication by integrating ACP states into both their respective RECs and the world market, is one of the three main objectives of EPAs. Non-governmental organizations (NGOs) like Oxfam often criticized the EPA process on the ground that the developmental issue has not been sufficiently addressed, fearing that the agreements instead of being conducive to development in the ACP countries, would rather be detrimental for the people living there[18].

Non-tariff barriers like Rules of Origin and SPS and TBT requirements, as well as trade regulations, accompanying measures and policies, and, effective processes for support delivery have to be addressed carefully. Adjustment costs and increased export volumes of European enterprises will need special attention in order to reach a pro-development outcome of EPAs. Trade regulations have to consider the different and specific needs of the regional groupings. Depending on their size, population and production sectors, the EU has to differentiate their trade-related actions.

If uncompetitive firms will be squeezed out of the market, further unemployment will be created. For these people, a safety net has to be created. Human resources development is necessary in order to find new working opportunities.

Beyond EPAs and their possible consequences, other elements have to be taken into account. Weaknesses at all levels prevent countries and their producers to export more and at a higher revenue. At the macro level, the lack of infrastructure and inefficient institutions is hindering fast and favourable trade and increases trading costs. At the micro level, producers sometimes do not know how to produce competitively or where and how to sell their products at a good price. Weak productive capacities, old trade-related policies, burdensome custom procedures, difficult compliance with SPS and TBT and restrictive Rules of Origin are all export constraints which will require special attention.

ACP countries have to overcome these constraints that deter them from taking full advantage of new market access opportunities to the EU and help them to integrate into global markets. Implemented in a multi-faceted approach, trade related technical assistance could bring sustainable growth and lead to poverty reduction.

Aid for Trade will be needed to achieve these stated objectives. Policies and accompanying measures have to be put in place in order to facilitate the implementation and mitigate the negative fiscal impact of the EPA. Long-term commitments for trade-related technical assistance (TRTA), based on specific needs assessments, are the key to ensure that benefits can reach the most vulnerable.

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[17] EC, EPAs, Start of negotiations, A new approach in the relations between the European Union and the ACP countries, September 2002

[18] Oxfam Briefing Note, "Unequal Partners: How EU–ACP Economic Partnership Agreements (EPAs) could harm the development prospects of many of the world's poorest countries", September 2006

Between 2002 and 2005 total Aid for Trade donor commitments reached $ 21 billion per year or 34% average share in total sector aid[19]. This figure includes:

- $ 0.6 billion for *Trade policy and regulations;*
- $ 11.2 billion to build economic *infrastructure;* and
- $ 8.9 billion to promote *productive capacities* (including $ 2 billion for *Trade Development*).

Aid for Trade is a key complement to, but not a substitute, for further trade liberalization under the EPAs. Increasing supply-side capacity and removal of structural weaknesses is key for a successful EPA implementation. This has also been reaffirmed by the European Commission in a recent communication[20]. EC's overall trade-related assistance between 2001 and 2005 amounted to € 1.619 million for ACP countries[21].

Aid for Trade has been a controversial issue in the EPA negotiations. The 6 regional economic communities wanted to see trade-related assistance included in the negotiations, while the EC clearly wanted to separate market access negotiations from additional aid commitments. The reason was that the Cotonou Agreement foresaw only trade and trade-related issues to be discussed in the framework of EPAs and that a negotiation of policies should not turn into a negotiation over trade flows.

The main financial mechanism for ACP countries is the European Development Fund (EDF). The 10th EDF amounts to € 22.6 billion for this period up from € 15.2 billion for the 9th EDF. According to the EC a huge part of the substantial increase will be used for EPA related projects and programmes. The following budgets for support at the regional level under the Regional Indicative Programmes (RIPs) have already been allocated under the 10th EDFs (2008–2013):

- West Africa: € 478 million (250% increase over the 9th EDF);
- Central Africa (CEMAC): € 127 million (100% increase over the 9th EDF);
- East South Africa (ESA): € 465 million (108% increase over 9th EDF);
- Southern Africa (SADC): € 135 million (reduction from 14 to 7 beneficiary countries - amounts to a 33% increase over 9th EDF for the 7 countries);
- Caribbean: € 132 million (93% increase over 9th EDF);
- Pacific: € 76 million (130% over 9th EDF).

Since other development programmes concerning health, water, rural development and other areas are addressed under the EDF, civil society organizations fear that the strengthening of trade-related technical assistance may lead to neglect other priority areas.

Furthermore, despite the impressive nominal increase from the 9th to the 10th EDF, Grynberg and Clarke note that the jump, when adjusted for inflation, is rather negligible[22]. Between the 4th and the 9th EDF nominal increase was 348%, but with 1975 as a base year the increase was only a mere 16%. To make things worse, the

[19] OECD, WTO: Aid for Trade at a Glance 2007 (1st Global Review), 2007.

[20] EC, Communication from the Commission to the Council, the European Parliament, the European Economic and Social Committee and the Committee of the regions, Towards an EU Aid for Trade strategy – the Commission's contribution, COM (2007) 163 final, {SEC(2007) 414}, April 2007

[21] EC, DG EuropeAid, AIDCO Annual Report 2006

[22] Grynberg, R. and Clarke, A., *The European Development Fund and Economic Partnership Agreements*, Commonwealth Secretariat, Economic Affairs Division, 2006

percentage of total disbursements of the 9th EDF has only been 28% until now.

The EC's clearly admits that EPAs will suppose a financial challenge for countries at the macro, meso, and micro level. ACP countries will have to struggle with its implications from the first day they will come into force. Therefore, the EC and its member states strive to increase their volumes of EU Aid for Trade to € 2 billion a year by the year 2010. €1 billion will be pledged by the EC, €1 billion by the 27 member states (additional to 10th EDF). The percentage reserved to support the ACPs should be in the range of 50%.

- € 1.5 billion for production and employment adjustment assistance; and
- € 2.3 billion for human resources development and productivity enhancement support.

This study takes into account the degree of adjustment that countries will have to undertake and the difference in country size. Based on existing adjustment programmes being financed by the World Bank, the financial requirements arising from the design and implementation of mitigating measures are then calculated.

**Table 4: Estimated Adjustment Costs by Region**

| Region | Fiscal Adjustment | Export Diversification | Employment Adjustment | Skills/Prod. Enhancement | Total Adjust. Costs |
|---|---|---|---|---|---|
| Central Africa | 320 | 307 | 193 | 265 | 1085 |
| West Africa | 925 | 682 | 416 | 690 | 2713 |
| East South Africa | 775 | 702 | 375 | 630 | 2482 |
| Southern Africa | 340 | 261 | 217 | 255 | 1073 |
| Caribbean | 355 | 189 | 134 | 195 | 873 |
| Pacific | 210 | 175 | 82 | 175 | 642 |
| Gross Total | 2.925 | 2.316 | 1.417 | 2.210 | 8.868[24] |

***Source:*** *Adapted from Milner et al. (2005)*

It is difficult to assess if the amount of Aid for Trade pledged by the EC and their Member States will be sufficient to address all adjustment costs related to the implementation of EPAs. Costs will vary between regions and furthermore between different ACP countries. A study conducted by Milner[23] and commissioned by the Commonwealth Secretariat shows that the total EPA costs of adjustment would amount to € 9.2 billion, including:

- € 3.3 billion for fiscal adjustment support;
- € 2.1 billion for trade facilitation/ export promotion support;

At the regional level the costs are distributed as set out in Table 4 above.

In addition to EU funds, other funding mechanisms in support of global Aid for Trade initiatives are in development, such as the Integrated Framework[25] (IF) and the WTO Aid for Trade Initiative, and should help ACPs to address EPA challenges.

Beyond the volume of aid, which is important, the capacity to utilize available funds effectively and ensuring the quality of aid is a key issue. The Paris Declaration on Aid Effectiveness of 2005 clearly lays out the principles of effective Official Development Assistance (ODA) spending

[23] Milner et al., "Some Simple Analytics of the Trade and Welfare Effects of Economic Partnership Agreements", *Journal of African Economies, 14(3)*, pp. 327- 58, 2005

[24] Due to data constraints a number of countries are excluded from calculations. This is why the sum does not equal the calculated €9.2 billion.

[25] Only available for LDCs

and should be put at the heart of the Aid for Trade agenda. This includes ownership of the policies and strategies by the partner countries, alignment of donors to the partner countries' national development strategies, harmonization among donors, managing for results and mutual accountability for the results obtained.

From draft EU/ACP EPA legal texts[26] emerge that the EU recognizes the importance of cooperation in industrial development and competitiveness with the objectives of

- establishing, developing, restructuring and modernizing a regions' industry and
- establishing an environment favourable to the development of private enterprise in order to stimulate the growth and diversification of industrial production.

Areas of cooperation should therefore include:

- Promote the development of activities in the areas of production, processing, marketing, distribution, financing, and development of commodities;
- Promote collaborations in Research & Development and encourage knowledge and technology transfers;
- Promote and strengthen innovation, diversification and value addition product development and quality;
- Strengthen the financial system in order to reduce the high transaction costs of financial intermediation for both short term and long term capital and especially for MSME;
- Assist SMSE to insert into national and global value chains in view of trade liberalization;
- Capacity-building at the institutional and industry levels for SMEs;
- Initiate public private partnerships and improve the dialogue between them;
- Capacity building for public and private sector;
- Trade and investment promotion;
- Encourage backward and forward linkages between the EU and the countries of ACP regions and support Cluster and Networking Development;
- Assistance to comply with the requirements of the WTO TBT and SPS agreements.

[26] e.g. Draft EU – Eastern and Southern Africa EPA, July 2007

# PART II: OPPORTUNITIES AND CHALLENGES OF EPAS IN AN INDUSTRIAL CONTEXT

> *"The proposed EPAs imply nothing less than a fundamental restructuring of the political and economic relations between the EU and ACP countries."*
>
> **OXFAM**[27]

## 1. Regional Integration

Article 35 (2) of the Cotonou Agreement states that "*Economic and trade cooperation shall build on regional integration initiatives of ACP States, bearing in mind that regional integration is a key instrument for the integration of ACP countries into the world economy.*"

The EU is striving to establish North-South-South arrangements. At sub-regional level, Customs Unions (CU) with a Common External Tariff (CET) are envisaged in most of the RECs.

The link between regional integration and development, in the European context, has been materialized through a common legal framework and common policies. Pooling of resources should lead to greater trade and investment, increased diversification and value addition. In the ACP context, it is expected to stop the dependency of many ACP countries to a few developed country markets. Economies of scale increase with the size of the market, which allows small and medium enterprises to expand and reduce their production costs. Tariff cuts also lead to cheaper intermediate inputs and consumption goods. Intra-regional trade in developing countries can be seen as a motor for growth and development.

However, regional trade agreements (RTAs), though numerous in the South, have had little impact until now on ACPs world share in trade. Especially, Africa has been marked by distorted trade regimes and high transaction costs due to inappropriate transport, communications and information infrastructure. To add insult to injury, a lack of political commitment, administrative resource and harmonization in the different RECs combined with overlappings between the arrangements, has made things worse.

Overlapping memberships between the various RECs have a cost. Negotiating resources and capacity have been put to the test in the last years. Multiple membership fees are expensive to pay and maintain. Numerous and conflicting objectives among rival arrangements have contributed to a lack of progress in many areas[28]. To improve this situation, ACP countries should at the same time pursue non-discriminatory liberalization and regional integration.

In the longer term, the obvious solution to the question of overlapping membership would be the creation of a pan-African economic community, including a free trade area and subsequently a Customs Union, as stated in the Abuja Declaration[29].

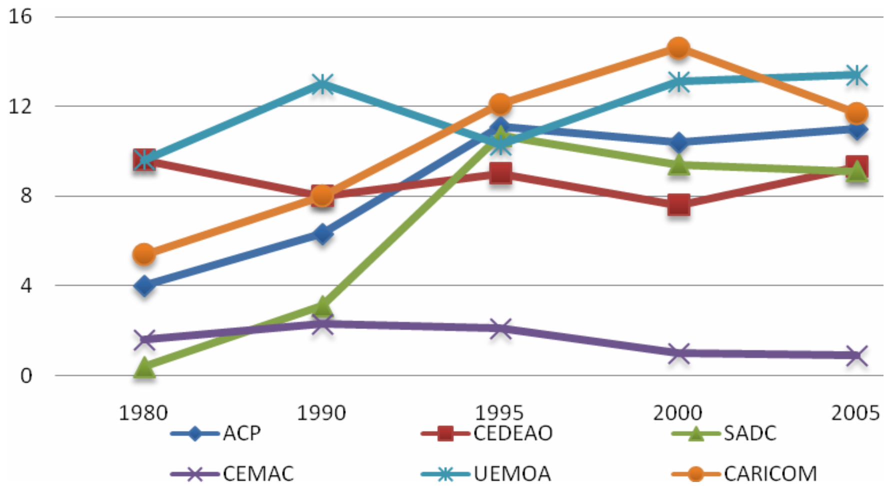
In 2005, only 11% of ACPs trade occurred within the region, while at the same time it was 66% within the EU. In CEMAC and COMESA, two EPA negotiation regions, intra-regional trade is currently below 5% (see Figure 5).

[27] OXFAM, "Unequal Partners: How EU–ACP Economic Partnership Agreements (EPAs) could harm the development prospects of many of the world's poorest countries", *Oxfam Briefing Note*, Page 3, September 2006.

[28] Iqbal, Z., and M. Khan, eds., "Trade Reform and Regional Integration in Africa" Washington: International Monetary Fund, 1997

[29] UNECA, *Economic Report on Africa 2007* - Accelerating Africa's Development through Diversification, 2007

**<u>Figure 5:</u> Intra-regional trade of EPA regional communities**




***Source:*** *UNCTAD Handbook of Statistics 2006-07*

## THE WAY FORWARD

Addressing and solving political tensions and conflicts, especially in Sub-Saharan Africa, are the basic pre-requisites for the development of viable economic communities. Further regional integration in Africa can be a means for achieving industrial modernization by encouraging intra-regional trade and securing economies of scale through facilitated market access. High tariffs among ACP countries continue to constrain the prospects for expanding South-South trade in manufactured goods. Reducing or eliminating tariffs within a region would pave the way for integrated sub-regional markets. Trade facilitation issues, like poor transport infrastructure and burdensome border controls have then to be addressed efficiently. The regions should seize the opportunities arising from pooling resources together rather than developing incompatible regimes and policies. The strengthening of regional integration should contribute to enhancing productivity and competitiveness through cluster development methodologies, creating linkages with broader national and international value chains, promoting domestic and foreign investment and diffusing improved technologies.

The elimination of intra-regional trade barriers should provide the basis for consequent trade development and welfare enhancement both at national and regional levels. Harmonization within the RECs will be necessary to determine more precisely the sensitive sectors to be protected and the sectors where further trade liberalization will be possible within the EPA.

## SENSITIVE SECTORS

Regional negotiating groups in the EPAs may consider putting those products on a sensitive list for the transitional period, if huge amounts of this product were previously imported from the EU or are expected to be. If these products were subject to high import tariff rates, they were consequently generating important tariff revenues. In some countries, the 20% most profitable products cover more than 70% of the revenues. Increasing imports in ACP countries, in absolute terms or in relation to the national production, could cause a serious damage to sensitive sectors both at country and regional levels. As a result of improved market access, some sub-sectors in ACP, contributing substantially to GDP, may enjoy particularly high growth rates in terms of EU imports, and consequently placed on the exclusion list as well.

Products from the agricultural sector are particularly sensitive since they contribute to income generation and national wealth. European agricultural products, which are sometimes highly subsidized, will directly compete to local products in labour-intensive sectors where the poorest population lives. For example, cotton, crops, oilseeds or vegetables may be considered as sensitive products. This issue is particularly critical since the agricultural sector remains, overall, the single largest contributor to employment in ACP states.
The manufacturing sector, which also employs a large number of people could be at risk as well. A further price decrease in the prices of products in that sector may harm producers.

Moreover nascent industries, with favourable prospects of sector and products development, should be protected. Increasing amounts of imports could threaten above all SMEs. It should be noted, however, that competition could lead to the largest efficiency gains, meaning that enterprises will be forced to be more productive and produce at lower costs.

Products should be classified in three categories taking into consideration their sensitiveness for each country: not facing competition between regions; competing but not strategic products; and, competing and strategic products.

However, in order to keep trade diversion low and because of protectionist interest, it is likely that pressure groups will try to influence decisions and liberalize trade where few domestic production exists and the highest revenues are achieved.

Furthermore, ACP countries have different priorities when it comes to protect domestic products from import competition. Stevens[30] discovered that if a country would include products in the exclusion list with a tariff of 40% or higher, there will not be a single product appearing on the exclusion lists of any member of the group.

The transitional period and the possibility to protect sensitive sectors for a certain period of time, should allow the development of intra-regional markets and subsequent to seize economies of scales necessary for international competitiveness.

[30] Stevens, C. and Kennan, J.; "EU–ACP Economic Partnership Agreements : the effects of Reciprocity", *Briefing note*. Brighton: IDS. p.3, 2005.

## 2. ACPs Productive and Trade Capacity

> *"Trade will not promote development without parallel investment in the supply side."*
>
> **Peter Mandelson, European Commissioner for External Trade**[31]

Under the Cotonou agreement, ACP countries have preferential access to the EU market for nearly all goods. 97% of their exports enter the EU duty free. The remaining three per cent result from 919 tariff lines in sensitive sectors that are not qualified for preferences under the Cotonou agreement[32].

The EPAs would give ACP countries the opportunity to retain and further improve their current level of access to the EU. The EC announced to offer full market access[33] to ACP regions in EPAs negotiations, meaning that all remaining quota and tariff limitations will be removed immediately[34].

This is especially important for the 37 developing, but not least-developed ACP countries, since they don't fall under the Everything But Arms (EBA) initiative of the European Union. This initiative allows LDCs to export all products (except arms) duty free and quota free to the EU. Without the successful conclusion of EPAs, non-LDC countries could still export under the GSP, where the preferences vary depending on a product being categorized sensitive or non-sensitive. GSP is a voluntary scheme, with preferential access to the EU market applying to all developing countries. However, the GSP does by far not offer the same level of market access than under Cotonou. The average tariff is at 20% so that in the case of West Africa more than €1 billion of trade would potentially be lost.

Nevertheless, EPAs will further improve market access since periodically reviewed conditions like in the EBA and GSP scheme could be subject of possible market access withdrawal. Not only it causes uncertainty for the local producers in the ACP countries, but also discourages foreign enterprises to invest in certain sectors. This, in turn, leads to a less diversified export structure. Also, the 919 tariff lines included sensitive sectors, such as agro-processed food, where many ACP countries could expand export activities. EPAs are therefore an opportunity to enhance market access and keep it at a constant level.

Anyway, the reason why ACP states still play a minor role in world trade, and did not reap benefits from Cotonou, cannot be found in the remaining existence of tariff barriers. The key hurdle are rather supply-side constraints that have urgently to be removed in order to ensure necessary quantity and quality supply and to strengthen export supply capacities for intra- and interregional markets. Standard compliance is an essential mean for this, in order to conform to international market requirements.

Seizing market access opportunities leads to an increase of economic growth what in turn not only increases government revenues but also has the potential to create productive employment opportunities and to improve household incomes.

[31] Financial Times: Feb 17, 2005: "International Economy & Asia-Pacific: An uneasy marriage with the free market".

[32] Hinkle, L.E., and R.Newfarmer. "Risks and Rewards of Regional Trading Arrangements in Africa: Economic Partnership Agreements (EPAs) Between the EU and SSA." *Development Economics Department*, World Bank, Washington, D.C, 2005.

[33] Exceptions will remain for rice and sugar that will have a transitional period.

[34] EC, "EU offers full market access to Africa, Caribbean and Pacific regions in EPAs negotiations", Brusses, IP/07/476., 4 April 2007.

The former Secretary General of the UN, Kofi Annan, claimed that "LDCs have neither the surplus of capacity of exportable products nor the production capacity to take immediate advantage of new trade opportunities"[35].

### SUPPLY-SIDE CONSTRAINTS

Economic growth is a necessary means for development. A sustainable growth in productivity, mainly in the manufacturing sector, could substantially contribute to poverty reduction and lead to wealth creation through an increased demand for productive employment. Industrial development through productive activities is therefore key to achieve the Millennium Development Goals.

As illustrated in the first chapter, manufacturing in ACP countries still does not reach a substantial share in GDP. Micro, small and medium enterprises (MSME) are the main pillar in countries of this region, given that, overall, the majority of the population is working there and their value-added per employee in dollar terms is three to four times higher than in larger enterprises. However, they have a lack of productive capacities. Enterprises are not sufficiently developed.

Various reasons hinder the establishment of internationally competitive enterprises: at the individual level these are a generally weak health system unable to reach people in rural areas, hunger and malnutrition and low education levels of the working age population. At the enterprise level an unfavourable financial situation with difficult access to loans, old technology with ill-equipped capital goods and inadequate managerial skills constitute the major constraints. Furthermore, landlocked or small-island states face special problems since they are remote from international markets and have a poor physical infrastructure.

Especially the 41 LDCs in ACP need to enhance their capacity to add value to agricultural products and enter into the global production system based on a value chain approach. These countries, weak in terms of human resources, are relatively well endowed with low-skilled workers generating opportunities for labour-intensive methods. Better use of production factors, including financial, natural, human and physical capital, will help to expand production. For this purpose entrepreneurial capabilities have to be developed.

A dynamic private sector, with multiplication and better utilization of production linkages (including backward and forward linkages between large, medium, small and micro enterprises, informal and formal enterprises, domestic and foreign enterprises) is an essential prerequisite for triggering economic dynamism, enhancing productivity, transferring and diffusing new industrial technologies and improving competitiveness.

Enterprises have to produce at competitive costs by being more productive. Manufacturing capability in terms of price, quality and innovation has to be created. Therefore, the private sector in ACP countries needs to provide a conducive legal and regulatory framework, which supports private enterprises, especially MSMEs.

Furthermore, production in ACP countries is limited on a few products. The export structure needs to be corrected over time, by seeking for new production possibilities. Especially in resource-intensive countries, it is essential to move away from unprocessed agricultural goods, oil in raw form and uncut diamonds towards more value-added in export-processing industries. Sustained economic growth is associated with the capacity to diversify domestic production structure. In emerging East Asian markets, such as China and India, cost of labour is rising and incomes are getting higher which offers new prospects to ACP enterprises.

Countries must have marketable products for exportation. The issue of export becomes fundamental to understanding the specialization process. Relatively few firms in Africa, Caribbean and Pacific export;

[35] Financial Times, 5 March 2001

most of them are not specialized in exporting. It is therefore difficult to sustain productivity and upgrade in terms of increasing the technology content. Competitive, safe, reliable and cost-effective products have to be offered to world markets, until now absent in most enterprises. This can be achieved through efficient upgrading of the industrial productive capacity at both the institutional and enterprise levels.

In order to connect ACP countries successfully to non-domestic markets trade capacities have to be created and maintained. Without such capacities ACP countries will be unable to benefit from the new market opportunities arising from the EPAs. Poverty reduction-oriented growth strategies should aim at supporting the development of MSME into dynamic, innovative and growth-oriented enterprises in order to be on a par when industrial tariffs are reduced and oversea enterprises will directly compete with domestically produced goods. It is recommended to focus on sub-sectors with a high export potential. Assistance for financing international trade in most ACP countries is difficult to obtain because of few banks willing to offer micro credits for MSME. A weak financial system is reflected in the high transaction costs of financial intermediation that reflect the underlying risk associated with political and economic instability, weak legal systems and informational problems.

EPAs offer the right framework for addressing both supply-side rigidities and demand-side constraints. Adjustment measures should generate new activities and enhance the role of manufacturing in economic transformation. This includes UNIDO's upgrading and modernization of industries programme that has the potential to strengthen national capacities and maintain the dynamic process of integration of exports, employment and industrial growth in the context of globalization and ACP trade liberalization, thus making an effective and coherent contribution to development. This approach is also in line with the African Productive Capacity Initiative (APCI), adopted by the New Partnership for Africa's Development (NEPAD) as its industrial component

## QUALITY INFRASTRUCTURE, SPS AND TBT

Increasing supply capacity is essential to, but not sufficient for, gaining entry into world markets. Once the critical export quantity is achieved the problem of reaching a certain quality requested by international markets arise and the associated challenge of proving conformity with international standards and technical regulations.

This requires establishing efficient testing, calibration, certification and accreditation mechanisms that conform to the requirements of the SPS and TBT agreements and enjoy international recognition. This takes on extreme importance for ACP countries wanting to benefit from trade opportunities.

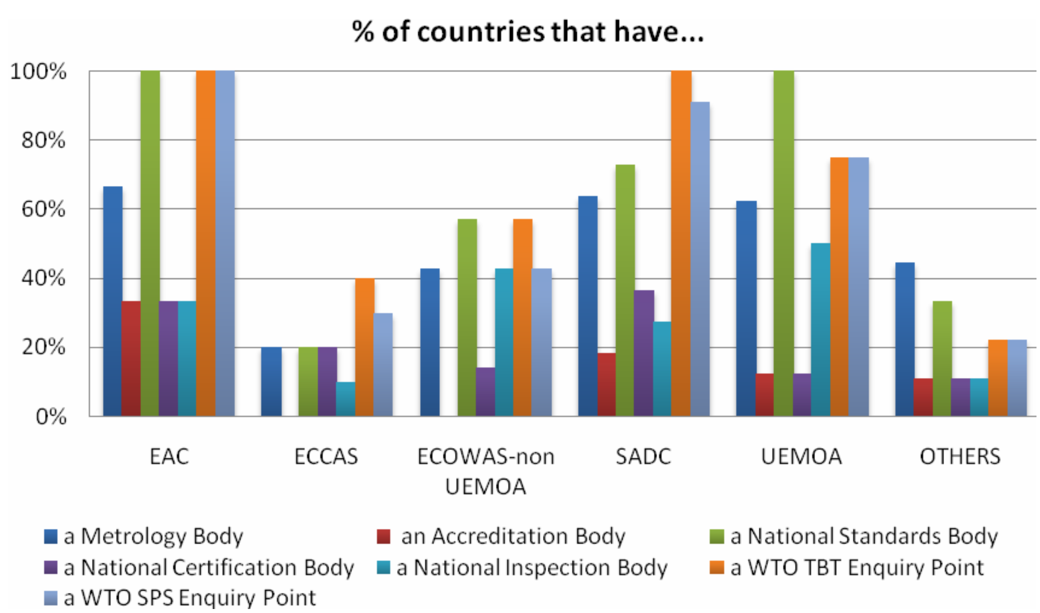
ACP have to prove compliance with quality standards and adequate quality infrastructure (QI) has to be put in place. QI is defined as the combined institutional framework related to standardization, quality management, metrology, testing, inspection, certification and accreditation. The overall objective of the QI is to improve the quality of products, processes and services and to effectively demonstrate through adequate conformity assessment procedures that these products, processes and services comply with requirements such as standards or technical regulations.

However, if the quality infrastructure is to effectively support exports, it has to be recognized internationally. This is achieved by ensuring that its apex institution, namely the accreditation body, becomes signatory to international mutual recognition arrangements. Quality infrastructures established in African countries need to link to the relevant international organizations and operate in accordance with the same international standards as in industrialized countries.

UNIDO undertook a survey in 2006 showing that the level of development of the QI in Africa is quite low because very few countries have the totality of the elements that constitute an adequate QI (see Figure 6). QI institution building should be done in conformity with international norms in order to remove technical barriers related to standards, technical regulations and conformity assessment procedures in trade. However, many African countries are not members of international organizations.

On the whole, serious efforts have to be made to upgrade the level of the QI institutions but also to enhance the capacity of manufacturing firms to implement quality tools and use conformity assessment services.

**Figure 6: QI institutions in SSA**




***Source:*** *UNIDO survey, UNIDO database and website info*

The mere existence of QI institutions is not sufficient since the operational status and technical competence of these institutions have to be qualified. Many countries may have existing QI institutions, which, not for all intents and purposes, are operational. There is a general lack of accredited testing or calibration laboratories that are internationally recognized. This, in turn, weakens all other conformity assessment areas such as certification or inspection, which rely on testing and calibration.

Few certification bodies exist although certification worldwide has kept on increasing at a rapid pace. It includes standards for food hygiene and safety (ISO 22000), quality management (ISO 9001), environmental management (ISO 14001) and social accountability (SA 8000), as well as corporate social responsibility (CSR). A pro-active approach is needed to keep pace with international requirements.

The following areas need special attention resulting from an insufficient QI infrastructure in ACP countries:

Quality Promotion:

- No or few quality policies, productivity awards or quality awards;
- No or insufficient legislation for quality control and consumer protection;
- No or few ISO 9001 auditors.

Accreditation, metrology, standardization, testing, inspection, certification:

- Few countries have a national accreditation body (AB), a metrology body, a national Standardization body (NSB), a national inspection body, a national certification body;
- Existing bodies are understaffed, need training or have old/few equipment;
- Few countries possess internationally-recognized accredited laboratories or certification bodies;
- Countries are not members of International standards, metrology Organizations;
- Rarely signatory to international recognition arrangements;
- Standards vary across regions or countries, no harmonization.

Traceability:

- No legislation on traceability;
- Inaccurate and untimely traceability of products and activities in the supply chain;
- Low capacities to undertake trace-back and trace-forward activities;
- Insufficient levels of local expertise.

## Sanitary and Phytosanitary Standards (SPS)

According to the World Trade Organization, the aim of SPS is to protect human, animal or plant life or health within the territory of the Member from risks arising from pests, diseases (also carried by animals or others), additives and contaminants[36]. The WTO SPS Agreement is the international legal framework on how to set and apply SPS measures in the international trading environment.

The hurdles that ACP countries face to conform with SPS requirements are too high sometimes: they distort the distribution of gains from trade, are too burdensome for small and medium enterprises, and are changing too fast[37].

These disadvantaged countries have therefore longer implementation periods and receive technical assistance in this area. There is however the concern that ACP countries will lose market access to the EU because of stricter SPS measures since they are not able to make use of the instruments provided in the SPS Agreement to facilitate market access[38]. Despite the considerable amount of ODA earmarked for SPS, not many LDCs managed to introduce well-designed food safety assurance and control systems until today. ACP countries find themselves in a difficult situation since they lack the capacity to comply with SPS requirements and the capacity to assess conformity. The inabilities to fully seize export potentials and trade losses are the logical consequences.

Anyway meeting SPS requirements is costly. In the Kenyan horticulture sector for example, costs are estimated at $2000 per

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[36] See "The WTO Agreement on the Application of Sanitary and Phytosanitary Measures".

[37] The agricultural dimension of the ACP-EU Economic Partnership Agreements", *FAO commodities and trade technical papers, 8,* ISBN 92-5-105560-2, Rome 2006

[38] GTZ, Deutsche Gesellschaft für Technische Zusammenarbeit, "The relevance of SPS in the ACP-EU Economic Partnership Agreements: What a development-friendly recognition of SPS measures within the EPA negotiations might look like", Chemnitz, 2006

month at the farm level and at $123.000 from the farm to the port of export. The costs arising to developing countries to comply with food and safety regulations for the export of shrimps to the EU market are estimated by UNIDO at 2,8% cost increase for testing and compliance actions plus 5% cost increase for establishing quality and food safety activities at the enterprise level plus US$ 5-25 million for establishing a quality and testing infrastructure at the national level.

Depending on a country's composition of export products and looking at border rejections from ACP countries to the EU needs and difficulties can be identified. Between 2001 and 2003 there were 253 border rejections at EU borders from products originating from a few number of ACP countries (mainly Ghana, Nigeria and Botswana). Vegetables were the product group with the highest rejections, followed by fish and meat. Weighted data shows that Gambia, Niger and Sudan have the highest border receptions per trade volume. However, in comparison to other developing countries, the ACP countries have relatively low numbers of weighted border rejection.

A careful treatment of SPS related issues in the EPA negotiating process has to be ensured, also because ACP countries will possibly seize newly arising export potential in the area of agro-food processing. The EU ensured that if new SPS requirements will arise, they will be in compliance to the WTO SPS agreement.

To reduce the trade distorting effects of SPS measures in view of the upcoming EPA, the following issues should be addressed:

- Help ACP states to develop strategies in order to meet the most precluding SPS requirements standards (taking into consideration the costs related to SPS);
- Establishment of inspection sides within ACP countries to check for signs of disease before shipment. This would save costs and contribute to future increasing volumes of ACP/EU exports;
- Establishment of a Public Private Partnership between ACP governments and EU importers for strengthening ACP producer's capacities to achieve SPS requirements;
- Establishment of functioning food legislation, standards and regulations;
- Set up WTO SPS enquiry points and help deal with notifications and queries;
- Harmonization of regional measures and development of regulatory frameworks and policies;
- Establishment and upgrading of regional and national testing authorities and accredited laboratories in order to prove the authorities their compliance with the national, regional and international requirements. Food control laboratories should retain technical assistance and being modernized. An ACP specific regional network of accreditation organizations should be established;
- Combat the lack of awareness of standards and the lack of investment in creating a solid knowledge base at both the institutional (R&D) and human capital (training) levels;
- Encourage cluster development and joint ventures between ACP producers in order to pool resources and transfer technologies;
- Cooperation on all levels: between governments, producers, consumers and research institutes.

## Technical Barriers to Trade (TBT)

The way a product is labeled or packaged before it is sold or the shape, size, design, functions and performance of a product are specified in the TBT Agreement of the WTO. They are deemed to be necessary, mainly by developed countries in order to protect consumer's interest and the environment.

The total number of TBT notifications submitted by 84 members to the WTO between 1995 and 2006 amounted to 7744 notifications[39]. Out of the 875 notifications in 2006, more than 60% have been mentioned concerning the protection of human health or safety, followed by deceptive practices (22%) and protection of the environment (20%). 31% referred to more than one objective. The number of notifications could be even higher since many developing countries lack the capacities to initiate these disputes[40].

There is an increasing trend towards more and more complaints (See Figure 2 in the Annex). This can be seen as indicator for the use of technical measures as trade barriers. Civil societies often argue that those notifications only serve to protect domestically produced goods and are therefore another obstacle for developing countries' market access.

However, in Article 47(1) of the Cotonou Agreement, the EU accepted to remove unnecessary Technical Barriers to Trade in order to facilitate standardization, certification and quality assurance compliance for ACP countries. The EPAs offer additional possibilities to address TBT constraints through financial and technical support to enhance capacity for:

- Awareness raising of technical regulations
- Development, implementation and monitoring of technical regulations
- Establishing of WTO TBT enquiry points and help deal with notifications and queries;
- Helping ACP countries to comply with packaging, marking and labeling requirements
- Harmonization of national technical regulatory frameworks within RECs

## RULES OF ORIGIN

Restrictive and burdensome rules of origin are another factor that put burden on exporters in ACP states. The rules of origin (RoO) under the Cotonou agreement are seen as complex and as a hurdle for enterprises (especially in fisheries and textiles).

RoO set the parameters for preferential access to a given trade partner's domestic market. They define the conditions that a product must fulfill in order to 'originate' from the exporting country, which is granted preferential access. RoO should be transparent and should not have restricting, distorting or disruptive effects on international trade, as requested by the WTO Agreement on Rules of Origins. The main motivation for applying RoO is to prevent "trade deflection".

The EC recognized that current RoO are "too numerous and difficult", "complex" and "opaque, unequal and rigid"[41]. As a solution, the "Blair Commission" on Africa has recommended a 10 percent value-added rule as a nonrestrictive RoO[42].

The less protectionist RoO are, the less burdensome and costly is it for ACP producers to prove compliance. A simplification of RoO could facilitate market access, increase production, processing, quality and diversification of products. An opportunity for ACPs exist in the way that costs of production can be reduced if intermediary products can be imported. New production and export opportunities for value-added goods may arise for products that are not locally produced.

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39 WTO, Twelfth annual review of the implementation and operation of the TBT agreement, G/TBT/21/Rev. 1, 4 April 2007.

40 UNCTAD, *Trade and Development Report 2006*, Sales No. E.06.II.D.6, 2006.

41 EC, "Justification of the choice of a value added method for the determination of the origin of processed products". *Working Paper* TAXUD/1121/05 Rev.1 – EN. Brussels, 2005.

42 Hinkle, L. et al, "Beyond Cotonou: Economic Partnership Agreements in Africa". In: Trade, Doha, and Development: A window into the issues, Newfarmer, R. (ed.) Washington DC: The World Bank. 2005.

# 3. Trade Liberalization for EU Exports to ACP

> *"We want the future partnership between Africa and the EU to contribute to the development of the strong potential of the emerging African industry through a special and differential treatment."*
>
> **African Industrialists Association (AIA)**

With a successful negotiation by the end of the year 2007, EPAs will lead step-by-step to export reciprocity between ACP and EU. The 27 European Member states will therefore be able to export substantially all merchandise at a zero-tariff rate to ACP countries. A free trade zone will be established between the EU and ACP after a transitional period whereas 80% and more of trade have to be liberalized. Tariffs, quotas and other restrictions will therefore be removed gradually. This concerns all types of products: primary, agricultural, and manufactured goods.

Consequently trade creation and trade diversion effects will be generated:

***Trade creation:***

After a tariff dismantlement on imports from the EU, goods will be imported from the country within the EU that offers the lowest price. Consumers will be major beneficiaries from the EPAs since they benefit from a reduction in prices of the imported goods that now are domestic substitutes. Consequently, a shift in domestic consumer spending will occur. The expansion of demand leads to a rise in consumer surplus and a net improvement of economic welfare. Domestic producers lose since the price is reduced what in turn leads to decreased output of enterprises. Altogether, national welfare increases.

The same is valid for the other direction, ACP to EU, if tariffs in some sectors were higher in the EU than in ACP.

***Trade diversion:***

It arises when a FTA deviates imports from relatively efficient and cost effective producers in a country outside the FTA to less efficient producers in the EU, only because the tariff reduction makes their product all in all cheaper. Consumers will gain from the price reduction. Producers in the country with the new established FTA will have to face revenue losses. The reduction in the price of their product in the domestic market decreases producer surplus in the industry. The price decrease also results in a decrease in output of existing firms with the potential result that some firms have to shut down. This leads to an increase in unemployment, and a decrease in profit and/or payments to fixed costs. If the consumer is also a producer, as it is the case for many agricultural products in ACP countries, income will decrease for these sectors. Furthermore the government will not only lose the tariff revenue from the EU but also the tariffs from the country from which trade is diverted away. Trade diversion is normally welfare reducing. This is especially the case if trade is diverted away from another country in the region with the result of further hampering regional integration.

## EU INDUSTRIAL EXPORTS TO ACP AND TARIFF DISMANTLEMENT

The EC argues that openness generates predictable and positive consequences for growth[43]. In view of the EPAs the EC states that the gradually opening of the ACP markets will improve ACPs competitiveness as a result of economies of scales, diversification of exports and increased efficiency, and at the same time reduce costs and therefore consumer prices. Economic growth for the regions and greater investment inflows will be the positive consequences.

However also EU exports are expected to rise significantly in certain sectors. In 2006, exports from the European Union to ACP countries already amounted to € 34 billion, corresponding to 2,92% of total EU exports to the world. Primary products made up 23,9% but the bulk consisted of manufactured goods, namely 74%.

Between 2002 and 2006, exports rose by more than € 5 billion, with the highest increases in energy related products and machinery. Details of EU exports to ACP can be seen in Table 5 below.

The EU is the biggest import partner of ACP countries, constituting 24,7% of all imports. For the African ACP countries the share is even a 31%, and especially high in Central Africa (54%) and West Africa (33%) (see Figure 7 on the next page).

Governments in ACP countries achieve a not negligible part of their revenue through income taxes, consumption taxes and tariffs on imports. Although the share decreased in the last years, in some countries, import duties still account for 50 per cent of total government revenue.

Given the high share of imports from the EU and ACP government's dependence on tax revenue, it is intuitively clear that an elimination of customs duties would have considerable negative effects on countries revenue. This could further threaten already low government spending on crucial areas like education and health and thus also have implications on welfare. But again, this will only happen after a transitional period of 12 years or more while an estimated 20% can be left out of the liberalization process.

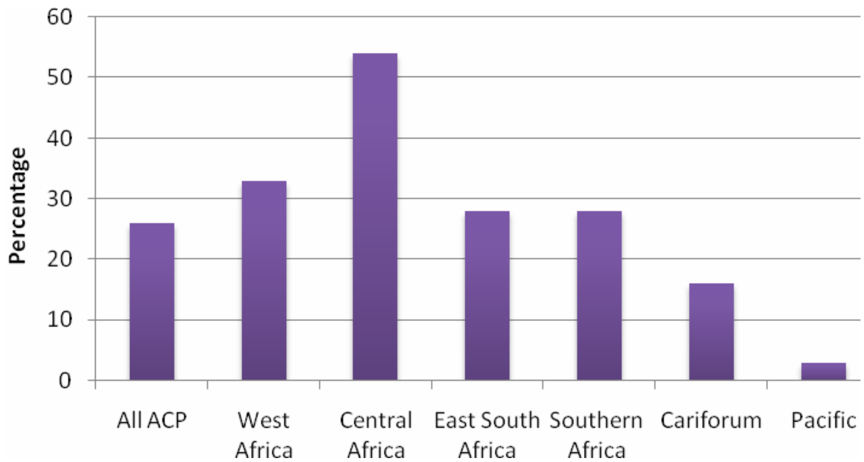
**Table 5: European Union exports to ACP countries in 2006**

| European Union, Exports to ACP (South Africa excluded) | 2006 (Mio €) | % | Share of total EU exports |
|---|---|---|---|
| **Total** | **34.033** | **100,0%** | **2,92%** |
| Primary Products | 8.123 | 23,9% | 5,33% |
| *of which* | | | |
| Agricultural products | 4.471 | 13,1% | 6,34% |
| Energy | 3.082 | 9,1% | 6,34% |
| Manufactured Products | 25.195 | 74,0% | 2,56% |
| *of which* | | | |
| Machinery | 9.824 | 28,9% | 2,92% |
| Transport equipment | 5.343 | 15,7% | 3,06% |
| Automotive prod. | 2.623 | 7,7% | 2,21% |
| Chemicals | 3.676 | 10,8% | 1,97% |
| Textiles and clothes | 528 | 1,6% | 1,44% |

***Source:*** *EUROSTAT (COMEXT, Statistical regime 4)*

[43] EC, Trading for Development - An European Union - Pacific Economic Partnership Agreement"; Office for Official Publications of the European Communities, 2007.

**<u>Figure 7:</u> Imports from the EU (as % of Total Imports)**




***Source:*** *Comext (2005), except All ACP (2006 Comext) and East South Africa (2004 UNSD COMTRADE)*

Nevertheless the right measures have to be put in place to ensure that the loss will be effectively compensated by other sustainable means.

Structural adjustment policies already lead to a decrease in MFN[44] tariff rates. For example, Nigeria's average tariff rate decreased from 30% to only 12% in the last years, Mauritius' from 18,4% to 3,5%. Non-agricultural tariffs are in almost all cases lower than the simple average of agricultural tariffs.

But MFN tariffs in most ACP countries are still much higher than in other developed countries for most products. Being 5.4% in the European Union, in single states they are two to three times higher. Moreover they vary significantly between countries of the same RECs as can be seen in detail in Table 3 in the Annex.

In Mauritius for example, average MFN tariffs are 3.5%, while in Comoros they amount to 29%. Additionally, in order to protect sensitive products and infant industries peak tariff rates are often applied.

As a result, the EU could enjoy trade preferences of up to 25 percent in average, leading to an increase of export quantities, mainly in the industrial sector. ACP industries will have to cope with a substantial increase in import competition. This could lead to bankruptcy of cost inefficient firms in ACP countries. Domestic industries have to be modernized and restructured by focusing on the competitive advantage in order to produce with lower costs at a higher quality. Also, to reduce the dependency from a small range of natural resources, industrial diversification is key to become more competitive on a long-term basis.

[44] Averages unweighted by the volume of trade

Industrialization should play a key role in the EPAs if recent economic growth in ACP countries should continue to prevail in the next years and decades and therefore be sustainable. As outlined before, in most ACP countries the majority of people however live from agricultural and agro-processed products where high commodity price fluctuations change harvest earnings from year to year. If then also natural disasters wipe out crops of the entire year, like it happened in September 2007 in Western, Central and Eastern SSA due to flood, it is intuitively clear that a higher share of GDP should be obtained from the industry sector.

In a UNECA study Karingi et al. investigated the implications of EPAs on SSA industries by means of a general computable equilibrium model[45].

Tariffs in Sub-Saharan Africa (SSA) on imported industrial goods from the EU are considerably higher than vice versa, with the exception of agro-processed goods (for details see Table 6). As outlined before, industrial productive and trade capacities are already low in ACP countries. The schedule for abolishing customs duties is of importance for ACP countries implementing EPAs, as they set out the time span to proceed to internal industrial adjustments before liberalization. Fast and imprudent industrial tariff liberalization will lead to de-industrialization and as a consequence lead to worsening of conditions of ACP livelihoods.

In the study a scenario has been simulated where all trade barriers between the SSA and EU are eliminated in both directions. This final stage of the EPAs, namely a free trade area, would only enter force after at least 12 years. They found evidence that there will be a serious risk of de-industrialization, most eminent for heavy, low-technology and medium-tech industries if during the transitional period sectors at risk will not enjoy accompanying measure for becoming more competitive (Figure 8).

As a result of the present tariff difference, capital-intensive heavy industries and low-technology industries will witness a reduction in output, in average at around 10% and 5% respectively. These industrial sub-sectors would offer the potential for diversification in high value-added products but are already now the main EU exports products to ACP which are likely to increase.

**Table 6: Difference between EU and SSA industrial tariffs**

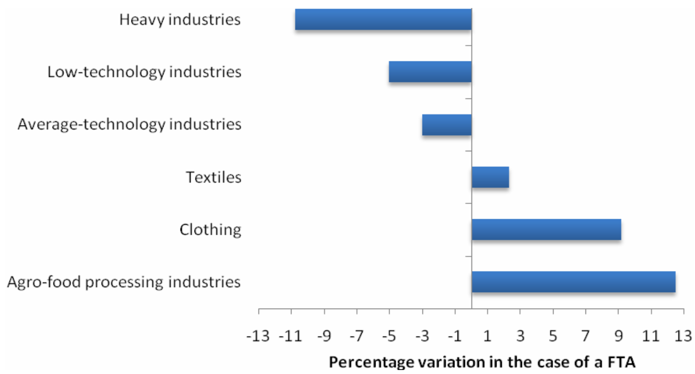
| | EU tariffs rates on SSA | SSA tariffs rates on EU | Difference |
|---|---|---|---|
| Agro-processed goods[46] | 39,4 | 23,9 | -15,5 |
| Textiles | 10,9 | 16,4 | 5,5 |
| Medium tech industries | 2,1 | 15,4 | 13,3 |
| Heavy industries | 1,4 | 15,8 | 14,4 |
| Clothing | 12,1 | 29,6 | 17,5 |
| Low tech industries | 2,6 | 23,5 | 20,9 |

***Source:*** *Karingi et al. (2005)*

[45] Karingi et al., "Economic and Welfare Impacts of the EU-Africa Economic Partnership Agreements", *African Trade Policy Centre, No. 10*, March 2005

[46] Meat: cattle, sheep, goats, horse; Meat products nec, Vegetable oil and fats, Dairy products, Processed rice, Sugar, Food products nec, Beverages and tobacco products

**Figure 8: Variation of selected industry sectors in SSA as a result of EPAs**




***Source:*** *Data from Karingi et al. (2005)*

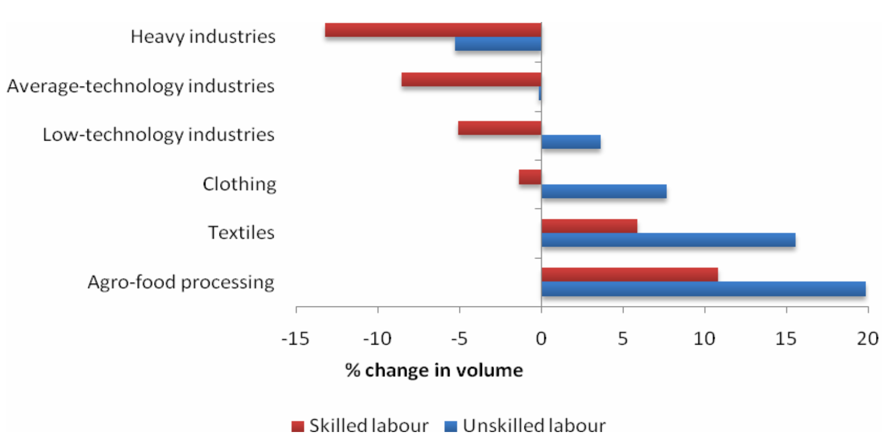
On the other side good perspectives exist for textiles, clothing and agro-food processing. These are labour-intensive manufactures where EU/ACP tariffs are not diverging too much. Growth rates in the order of 2 – 12 per cent are expected.

A similar picture is given if the endowment changes of skilled and unskilled labour are taken into account. Demand for mainly skilled labour in the heavy-, average-, and low-technology industries will contract as a result of outcompeted SSA enterprises. In manufacturing sectors clothing, textiles and agro-food processing mainly unskilled labour will be demanded. This results from an increase of output of these sectors and the specific demand of skills for these. Most ACP countries have high unemployment rates but are well endowed with low-skilled workers. These sectors will offer productive work for youth and stimulate the demand for high-educated university graduates.

Although these figures have to be handled with care due to data constraints and the limits of a computable general equilibrium models, they give a hint for the direction of industries in an EU/ACP free trade area.

ACP countries have the potential to build a strong industrial base but only if they have enough time, and, again, the right measures to build productive and trade capacities and diversify their industries. Therefore, upgrading and modernization of industrial enterprises should be among the priority Aid for Trade measures addressed by the EU in order to create industries able to compete with imported European goods.

**Figure 9: Demand for skilled and unskilled labour in SSA (volume terms)**




***Source:*** *Data compiled from Kharingi et al. (2005)*

Other studies assessed the economic and welfare impact of EPAs focused on regions and countries within the EPA negotiation.

Trade flows and government revenues changes in SSA have been examined. These are presented in the Annex.

## 4. Trade Facilitation

Trade Facilitation reduces the complexity and cost of international trade by applying internationally accepted norms, standards and best practices. It comes hand in hand with regional integration and offers opportunities to exploit unused potential in traditional export destinations by developing an institutional infrastructure and promoting private sector equity capital flows.

With the rising volumes of trade, it has become a burdensome procedure for many exporters and importers at the border: excessive documentation, slow and not transparent clearance procedures as a consequence of old customs techniques, high administrative fees, not adequate trade regimes and bad co-ordination between customs agencies are part of the everyday hurdles of exporters and importers.

Consequently, Trade Transaction Costs (TTCs) account for 2-15 per cent of traded goods' value in the World[47], and the percentage should be much higher in developing ACP-countries. If trade costs would be reduced by 50%, global trade in manufacturing could increase by up to $377 billion a year. This would triple the benefits for consumers as a result of consumption gains[48].

The road density and the quality of the roads play a significant role in trade costs, especially for landlocked countries in Sub-Saharan Africa. In that region the road density is estimated at 6.84km/100sq.km, that shows impressively the lack of a good road network compared to Latin America and Asia with twice and three times higher road densities. Moreover, in 2004 only 29.7 percent of Africa's total 2,064,613km road network was paved[49]. But even these roads are often in an insufficient condition for the safe and expeditious movement of cargo. Upgrading of a road can expand trade; in Kenya for example it would lead to 3000% trade increases[50]. As a result of bad infrastructure and a lack of political commitment, a multiple of checkpoints have to be passed on roads and rail networks. Legal and illegal roadblocks contributed to overall revenue losses of 2 billion FCFA in 1999 in eight ECOWAS member countries[51].

Also formalities to cross the border are hurdled and cumbersome. According to UNCTAD, customs transaction in Africa involves 20-30 different parties, 40 documents, 200 data elements and the re-keying of 60-70% of all data at least once[52]. As a result, transportation costs rise, vehicle maintenance costs and the duration for achieving the final destination rise as well. It is especially incriminating, if agricultural or perishable goods have to be transported since they have to reach the final destination in time and at a good quality in order to comply with SPS requirements in the EU.

According to the World Bank Doing Business report of 2007[53], regulatory

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47 OECD. Quantitative Assessment of Benefits of Trade Facilitation., Paris, 2003.

48 Dennis, Allen. "The Impact of Regional Trade Agreements and Trade Facilitation in the Middle East and North Africa Region." Policy Research Working Paper 3837. World Bank, 2006.

49 ECA, Trade Facilitation, *African Trade Policy Center Briefing No.1.* 2004.

50 Buys, Piet, Uwe Deichmann and David Wheeler. "Road Network Upgrading and Overland Trade Expansion in Sub-Saharan Africa." World Bank, *Development Research Group*, 2005.

51 ECA, "Assessment of Regional Integration in Africa", Addis Ababa , 2004.

52 UNCTAD, Transit System of Land locked and Transit Developing Countries. TD/BILDC/AC.1/17, Geneva, 2001.

53 World Bank, *Doing Business 2007: How to reform*, Washington DC, 2006.

procedures in the Sub-Saharan region are the most cumbersome and understaffed ones. However, there are huge differences within the regions:

- The number of documents required for importing goods range between 7 (Sierra Leone) and 20 (Rwanda);
- Documents necessary to export range between 3 (Tanzania) and 16 (Zambia).
- The number of days required to import goods varies between 16 (Mauritius) and 124 (Burundi).
- The Sub-Saharan region needs 40 days in average to export. (Differences can be seen in the Table below.

Every day a product is delayed in transit reduces trade by at least 1%[54].

The European Council recommended including these issues in the EPA negotiations. The objective should be to simplify and harmonize all requirements and procedures related to imports and exports, especially within the same REC. Particular attention should be paid to customs processes, import licensing, customs valuation, transit rules and pre-shipment inspection, in provisions of the WTO. Five areas concerning trade facilitation are part of EPA negotiations and should result in the following outcomes[55]: reduction of documentation requirements for goods in transit, improved customs processes, reduction of number and diversity of fees and charges, increase the level of transparency and ensure special and differential treatment with the help of capacity building measures.

**<u>Table 7:</u> Differences across the world in time to export (days)**

| OECD high income | Latin Am. & Caribbean | East Asia & Pacific | Middle East & North Africa | Eastern Eur. & Cent. Asia | South Asia | Sub-Saharan Africa |
|---|---|---|---|---|---|---|
| 11 | 22 | 24 | 27 | 29 | 34 | 40 |

***Source:*** *World Bank 2007*

[54] Djankov, Simeon, Caroline Freund and Cong Pham. "Trading on Time." *Policy Research Working Paper 3909*. World Bank, 2006.

[55] Mbithi, Economic Partnership Agreements (EPAs) Negotiating Issues: Trade Facilitation, Background Paper prepared for three day course on Regional Integration in Africa and the Economic Partnership Agreements, 22-24 May, 2006, Kenya, Nairobi.

# 5. Foreign Direct Investments (FDI)

According to UNCTAD's latest World Investment Report 2007 total Foreign Direct Investments (FDI) inflows in the world in 2006 rose by 38% to $1.306 billion while those to Africa incremented by 18% to $36 billion[56]. They are rising at a steady pace, recovering from a slump in the years 2000 to 2002. This is also a result of liberalization of African investment environments.

However, large parts of the FDI inflows to Africa were going to countries that are not negotiating EPAs, which means northern African countries and South Africa. $19.8 billion FDI inflows went to these countries, leaving $15.7 billion for EPA relevant countries in Sub-Saharan Africa. $4.5 billion and $ 289 million went to EPA countries in the Caribbean the Pacific, respectively. Therefore, the ACP region received approximately 1.56% of total world outward flows in the year 2006. Four ACP countries, namely Nigeria, Sudan, Equatorial Guinea and Dom. Republic made up already more than half of these inflows ($ 11 billion). These countries are huge oil and gas-producer what resulted mainly in investments of projects concerning primary production. Services and manufacturing (although declining) received large inflows, too.

By fostering regional integration, EPAs are expected to pave the way for increased Foreign Direct Investments (FDI). The EC points out that larger markets are key to attract further investments, since it means more potential customers[57]. The EC will finance infrastructure programmes under the 10th EDF, mainly concerning transportation, energy and inter-connectivity in telecommunications. The targeted areas would decrease the "Business Cost Factors" and therefore render investment more attractive in ACP countries.

While the ACP countries prefer investment promotion, capacity building and technical assistance, the EC wants rules-based investment agreements in EPAs.

FDI can bring economic benefits to developing countries, divisible in economic growth (employment, income, foreign exchange rate) and productive capacities (transfer of skills, spillovers in knowledge and technology, externalities, productivity)[58].

Most ACP countries are LDCs where poor people with low levels of education live. Enterprises might have difficulties to find adequately skilled workforce. Human resources development has to be strengthened in these countries, but this is time-consuming and requires extensive financial resources. The poor diversification of industries and concentration of FDI in primary sectors until now is not conducive for eradicating poverty. African FDI inflows are mainly resource seeking (oil and gas) and therefore delinked from the domestic economy. Profits obtained by the multinational corporations (MNC) are not reinvested; hence do not lead to economic development and increase of the manufacturing sector[59]. Regional integration is at risk because few efficiency-seeking FDIs are coming to ACP countries. But there seem to emerge another group of investors in Africa whose impact is more beneficial[60]. It is about SME who only recently entered the market. The investments by these companies are spread steadily between manufacturing and services. These enterprises have to be

[56] UNCTAD, World Investment Report 2007, Sales No. E.07.II.D.9., 2007.

[57] EC, EPAs: Means and Objectives, 2003.

[58] Zarsky, L., and Gallagher, K., "Searching for the Holy Grail? Making FDI Work for Sustainable Development", paper prepared for WWF-UK Workshop on International Investment Frameworks for Sustainable Development: Framing the Debate, London, March 10, 2003.

[59] UNCTAD, "Economic development in Africa : rethinking the role of foreign direct investment". New York and Geneva, p 7, 2005.

[60] UNIDO, Africa Foreign Investor Survey 2005: Understanding the Contributions of Different Investor Categories to Development. www.unido.org/doc/5413, Vienna, 2006.

attracted in order to generate local productive employment and generate spillovers in manufacturing.

In the framework of EPAs several important issues related to enabling ACP countries to become more competitive in attracting FDI, overcoming barriers to FDI, and maximizing the impact of FDI on sustainable, equitable and environmentally friendly industrial growth as well as promotion of FDI through business alliances, have to be identified. Furthermore, strategy and policy advice on FDI and institutional capacity building are critical success factors for attracting investors.

Last but not least, and as outlined already before, poor infrastructure and logistics are dissuasive for FDI. Broader Aid for Trade initiatives could help to address these obstacles and to diversify developing ACP economies.

# PART III: UNIDO'S RESPONSE TO EPAS

> *"The EPAs represent a clear opportunity and a challenge for industries in the ACP: They must be restructured and upgraded to be able to compete and to integrate in regional and international value chains. The motto is indeed: improve or disappear!"*
>
> **Dr. Kandeh K. Yumkella, Director-General of UNIDO**[61]

## 1. UNIDO's Productive and Trade Capacity Building Approach

Although its assistance is mainly provided at country level, UNIDO has developed over the years a regional approach through the establishment of Regional Programmes within its internal structure and with specific thematic programmes aimed to support ACP Regional Economic Communities (RECs).

UNIDO has established 5 regional programmes in order to cover its member States within a geographical approach: Africa Programme; Arab Programme; Asia and Pacific Programme; Europe and NIS Programme and Latin America and the Caribbean Programme.

The Long Term Strategic Vision adopted by UNIDO 11th General Conference 2005 in Vienna has focused its work on three thematic areas where its contribution can be most effective:

1. Poverty reduction through productive activities;
2. Trade capacity-building;
3. Energy and environment.

The following developments will be concentrated on the Trade Capacity Building area, which is the most relevant in the EPA context. However, the other thematic areas are also contributing to the regional programmes being developed by UNIDO.

Particularly established to support the preparation of developing countries and countries in transition for further trade liberalization, the area of Trade Capacity Building is based on the three Cs' approach: supply Competitiveness, demand Conformity, market Connectivity:

- **Developing *competitive* manufacturing capability** through upgrading of product and production quality, productivity enhancement, safety and cost-effectiveness improvement;
- **Developing and promoting *conformity* with market requirements** by establishing the necessary physical and institutional infrastructure to prove that products conform to the technical requirements laid out within the multilateral trading system with particular attention to the development of standards and conformity assessment infrastructures;
- **Enhancing *connectivity* to markets** through more effective participation in international trade negotiations and engagement in trade facilitation. In this area UNIDO cooperates with other organizations (UNCTAD, ITC).

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[61] Ceremony for Launching the Restructuring and Upgrading programme for UEMOA countries, Ouagadougou, 7 June 2007

Enhancing productive capacity is one of the most realistic and effective approach to ACPs sustainable participation in global production networks and segmented systems. Value-added needs to be generated at each stage of the segmented production process. Two segments in the value chain should be highlighted:

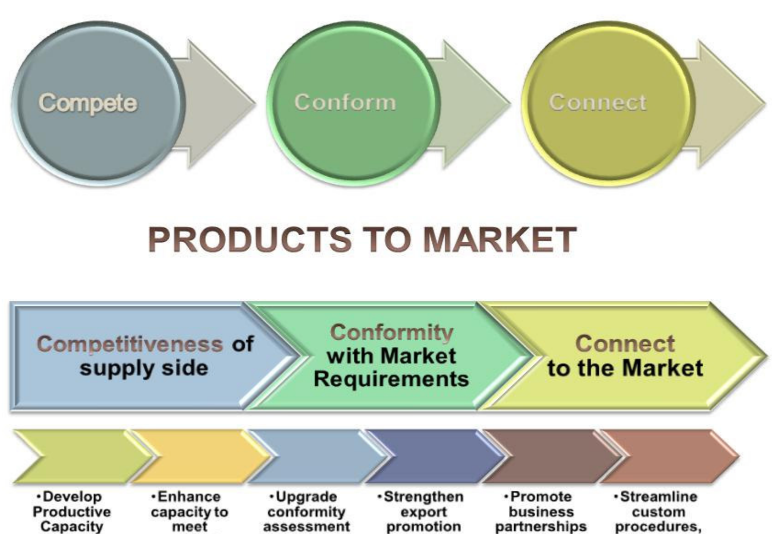
- Downstream segments: these are usually based on comparative and competitive advantages directly related to incremental value-added in each segment/stage of production. The value-added and technology content is low, as is the level of skills required.
- Upstream segments: these are usually based on cumulative advantages. Their focus lies on coordination, knowledge-sharing and brand-ownership in the global production systems.

The overall objective is to transform comparative and competitive advantages into cumulative advantages for ACP. Three key steps are essential to enhancing productivity at the local, regional and global levels:

- Linkages: improving internal and external linkages in building competitive productive capacities and capabilities
- Leverage: leveraging growth by reducing barriers to competition at all levels; and
- Learning: promoting a learning and innovative culture through clustering and networking approaches.

UNIDO's aim is to promote export-oriented production in order to eradicate poverty and to achieve the MDGs. It focuses on increasing developing countries' manufactured exports and value-added. Technical assistance for the upgrading of their institutions, support infrastructures and competitive productive capacities are provided in order to: facilitate their integration into the world market, overcome both tariff and non-tariff barriers to trade and, ultimately, create a favourable trade environment.

**<u>Figure 10:</u> UNIDO 3Cs' approach**



## 2. UNIDO Approach in the EPAs

In order to build a consensus on the needs assessment and on the trade related technical assistance necessary to prepare ACP regions for further trade liberalization, UNIDO has developed its programmes in partnership with the RECs and with the EC. As a technical partner, UNIDO is not involved in the EPA negotiations but its first role is to provide technical assistance to its member States. Both ACP RECs and the EC have been involved, since the very beginning of the programmes identification, in the elaboration of the Term of Reference of the various missions and were regularly briefed on the development of the programmes. This transparent mechanism has greatly helped to create a consensus on the analysis of the situation in ACP regions and on the adequate response to bring in terms of technical assistance.

In order to support its ACP member States in a critical time, UNIDO has decided to invest important financial resources to formulate these regional support programmes. As its ACP member States, UNIDO is convinced that regional integration and cooperation is essential for their progressive integration in the global economy. Since UNIDO regular budget resources dedicated to technical cooperation are limited to 6% as provided in its statute, UNIDO's investment in the formulation of the regional programmes can be considered as a real strategic orientation of its technical cooperation programme.

Given its recognized expertise and successful experience in the area of industrial upgrading and modernization as well as in the establishment of the Quality Infrastructure, UNIDO received requests from the 6 ACP RECs to assist in the formulation of regional programmes in the field of industrial upgrading and modernization. The EU agreed on UNIDO's assistance for formulation and supported UNIDO to participate in the RPTF.

## 3. Upgrading and modernization of industries for ACPs

UNIDO has developed technical assistance programmes in the area of industrial restructuring, upgrading and modernization to prepare and adapt industries and their environments to a changing global landscape, which is characterized by increasing competition. In the framework of EPAs, UNIDO's upgrading and modernization of industries programmes aim at preparing enterprises for international competition and at improving productivity, quality, competitiveness and increasing export capacities. Furthermore they aim at enhancing and supporting competitiveness of productive sectors in terms of price, quality and innovation with focus on SMEs, integration in global trade and growth at the industrial and enterprise levels. The objective is to prepare industries for increased EU import competition in the framework of EPAs and the global market.

The programmes are a pragmatic and effective instrument for industrial and trade development. Also technical support institutions, such as Quality and Standardization Institutes, will be taken into account and help them to comply with TBT and SPS requirements, among others.

The objectives of this programme are in line with: the Millennium Development Goals, the Doha Round and Doha Development Agenda and the African Productive Capacity Initiative adopted by NEPAD. Furthermore, the RECs are the owner of the programme and of its achievements and sustainability what is in line with the 2005 Paris Declaration on Aid Effectiveness.

UNIDO started formulation missions that will result/resulted in a full-fledged programme document, to be validated by the respective region and the European Commission with outcome-oriented impacts at the macro-, meso- and micro level.

The UNIDO programme of upgrading and modernization is based on a multifaceted approach and takes into consideration past programmes and lessons learnt.

It will be implemented through methods and tools adapted to the specific needs of ACP countries in the framework of EPAs with the following three integrated components:

### *Component 1:*

Support the upgrading and the competitiveness of industries and related services;

### *Component 2:*

Enhance capacities of quality infrastructure;

### *Component 3:*

Establishment/strengthening of the institutional and technical capacities and organs in charge of the restructuring and upgrading processes.

The outcomes of the three Components are:

### Component 1:

Support to upgrading and modernization of small and medium manufacturing enterprises and related services in high-potential sectors and markets largely contributing to regional and national economies. Industries in ACP will be assisted through immaterial and material upgrading activities in order to face regional and international competition and take advantage of the positive effects of trade liberalization. Immaterial upgrading activities include inter alia: strategic diagnostic, formulation of upgrading programme, assistance for the implementation of priority actions related to products and the production system, quality, marketing, information management, finance, traceability, partnership. Material upgrading activities include assistance for modernization of equipment.

### Component 2:

Establishment/strengthening of regional and national system for accreditation, standardization and quality infrastructure. Accreditation activities include: upgrading capacities of laboratories and setting up regional networks of specialized laboratories, harmonization of analytical procedures for analysis and testing. Standardization activities include: establishment of regional/national documentation centre for standards, harmonization of standards and technical regulations, development of a framework law for consumer protection. Quality promotion activities include: annual quality award, assistance for certification ISO 9000 of industries. Regional and national capacity in the field of quality will be developed.

### Component 3:

Diagnostic study and upgrading programmes will be elaborated and implemented for technical support institutions to improve capacities of institutions to assist in the upgrading and development of enterprises mainly in the areas of: technology, investment, export, vocational training, etc. Centres of excellence to support enterprises, strengthen the interaction between research and industry, use of technology to develop innovation will be promoted.

## UNIDO's industrial upgrading and modernization approach

Improvement of all competitiveness factors in the upgrading process is envisaged. For that purpose, an analysis at the macro, meso and micro level will be made at the initial stage. Several crucial factors for a successful outcome have to bear scrutiny.

The figure below gives an overview of UNIDO's Upgrading Approach.

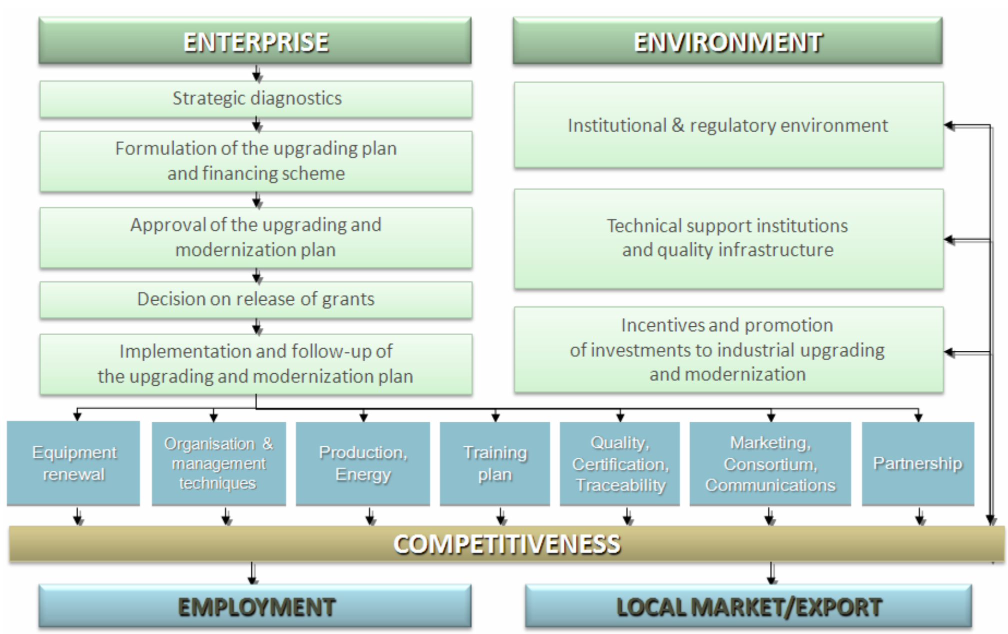
The initial stage has four consequent steps: the pre-diagnostics, the strategic diagnostics, support to the formulation and implementation of the plan for upgrading and modernization in close cooperation with the enterprise.

and plan for upgrading and modernization. The declaration of interest will be a part of the questionnaire to serve as an attribute of enterprise's fully voluntary participation in the current programme.

This step of the process determines whether the company needs to go through a prior stage of upgrading and modernization to benefit ultimately from the modernization stage.

2. In the context of globalization and rapid technological progress, the strategic diagnostics aim to analyze

**<u>Figure 11:</u> UNIDO Upgrading and Modernization approach**




1. The pre-diagnostics consist in conducting research campaign based on questionnaires, which are administered (1) to determine the eligibility of the enterprises to the plan for upgrading and modernization, and (2) to identify the field of survey to formulate and adopt the diagnostics

competitiveness of the local companies.

The diagnostics will thus reveal the strengths and weaknesses of the companies and will allow identifying the strategies to be followed as well as the short and medium-term actions for upgrading and modernization to be implemented within this programme. The diagnostics will also propose a financial plan to carry out the selected actions.

3. The restructuring plan covers mainly the structural and financial adjustments which could lead only to conversion or liquidation of nonviable activities or to financial reorganization of the company. The objective of the modernization plan is to enable companies to become financially sustainable and to meet the eligibility criteria to benefit from the upgrading plan.

4. The upgrading plan will mainly cover or review:
   - The short- and medium-term strategy and objectives;
   - Already implemented activities to raise the companies' interest;
   - The action plan of immaterial and material activities with special accent on companies' competitiveness;
   - The plan of financial sustainability of the company.

### The Tunisian national upgrading programme

On the 17th of July 1995, Tunisia signed an association agreement with the European Union. This agreement, which provided for the progressive establishment of a free trade area, offers to competitive Tunisian companies an opportunity to integrate into a developed economic area with more than 500 million consumers. Nevertheless, it contains threats linked to the liberalization of foreign trade.

To prepare and adapt the industrial enterprises and their environment to the new context, characterized by more competition, the Tunisian Government, in consultation with the social partners, designed and implemented a national programme for upgrading the economy and the industrial bases, starting by a pilot-upgrading programme with UNIDO's assistance. It focused on improvement of business environment and competitiveness of enterprises and enabled to strengthen three sectors: textiles and clothing, leather and footwear, and food.

UNIDO has contributed to the country's efforts to increase productivity, reduce costs and improve quality in the manufacturing sector, making it more competitive, increasing its share in global markets, boosting exports and creating employment.

Today, the important economic deadlines that Tunisia must face are succeeding one another. Nevertheless, after 11 years of implementation, it can already be argued that the upgrading program has recorded significant results and has been a remarkable success:

- 2300 enterprises with a total upgrading investment of $ 3.4 billion have benefited from this programme so far;
- Total upgrading grants: $ 500 million;
- Increase in employment in beneficiary enterprises: 12%;
- Total industry exports increased from $ 3 billion to $ 11 billion;
- Exports for beneficiary enterprises increased by 18% per year; FDI increased from $ 24 to $ 327;
- 11% of enterprises that have started exporting did not so before the upgrading programme;
- 8 technical support centres have been upgraded in the sectors textile, leather and food and technical support institutions upgraded and modernized;
- 900 enterprises have been certified with ISO 9001;
- 20 laboratories accredited to ISO 17025;
- Capacity building in the area of upgrading has been provided for more than 500 experts.

After the end of the Multifibre agreements in 2005 for textile and clothing, the industrial sector as a whole must continue its efforts to face the challenges for the full opening of the economic borders in 2008. That's the reason why a new phase of the upgrading programme, oriented towards innovation and regional and international technical partnership, has been implemented. Capacity building in the area of upgrading has been provided for more than 500 experts.

## UPGRADING TECHNICAL SUPPORT INSTITUTIONS

Upgrading technical support institutions is a key prerequisite to improve **marketing** and productive capacities and **competitiveness** of industries.

The majority of companies in the ACP region suffer from considerable technology gaps mainly characterized by a lack of know-how on technical procedures and quality/safety management systems along with the absence of innovation initiatives in introducing new products and technologies. Moreover, ineffective exploitation of productive capacities and inadequacies in equipment maintenance lead to fabrication of defective goods or to the total suspension of production process.

Often overwhelmed by these technical and organizational shortages, the companies are limited in their capacities to optimize their technological process that determine their competitiveness and their place on the market. As a result, these companies are unable to produce goods that can response to the current market needs and meet international quality standards, sanitary and safety requirements.

One of the main reasons for this appears in the weak technical skills and qualification of the technical support institutions. Their technical capacities are insufficient to satisfy the real needs of industrial sector.

The current situation analysis shows that the national R&D and training institutions, the specialized technical centers and laboratories, the controlling, auditing and certification bodies do not possess the necessary capacities to support the companies, which, in consequence, have to seek the foreign expertise that brings to the companies additional costs and thus affects their competitiveness.

It is, therefore, crucial to address capacities of technical support institutions within implementation of upgrading and modernization programme. The proposed approach, in particular, recommends:

***Step1:***

To assess current situation in the area of the technical support to industrial sector and priority related services. This step should identify (i) the number and list of technical support structures to be strengthened within technological upgrading activities and (ii) the nature and extent of needs in technological upgrading.

***Step 2:***

To prepare the plans for technological upgrading for each of the beneficiary structures. These plans, prepared in close cooperation with the national counterparts and programme beneficiaries, will particularly include the first-priority soft and material activities as well as the action plans.

***Step 3:***

To implement technological upgrading plans through:

- Upgrading infrastructure and equipment to attain compliancy with international standards and technical requirements;
- Upgrading methodologies for operations and technological process;
- Organization of trainings in horizontal and sectoral competencies (technology, quality, safety, standards/certification, etc.);
- Direct assistance and training throughout the exploitation process.

The following results are expected:

- Technical centers and training institutions strengthened or established in various industrial branches;
- Critical mass of national and/or regional expertise trained and operational;
- Regional network of institutions for technological support established and operational.

## ENHANCE CAPACITIES OF QUALITY INFRASTRUCTURE

The implementation of the UEMOA Quality Programme by UNIDO has highlighted the inherent difficulties faced by African countries which may be at considerably different levels of development within a regional integration group but this project has also demonstrated that measures can be taken to address weaknesses of the quality infrastructure while enhancing regional cooperation.

In the area of quality infrastructure, the following priority areas and the respective activities needed are overall needed in the ACP region.

### Quality Promotion

- Training in the field of quality and quality management
- Establishment of legislation for quality control and consumer protection
- Undertake quality awareness and promotion campaigns at the enterprises and consumers levels

### Metrology

- Acquire or upgrade metrology calibration and measurement equipment
- Training of the laboratory staff
- Set up metrology structures

### Accreditation

- Establish internationally recognized accreditation structure
- Train the local human resources
- Acquire IAF and/or ILAC recognition/Membership

### Standardization

- Training of the standardization structures' staff
- Creation of standardization structures
- Raise awareness on the role and importance of standards

### Analyses & Testing

- Acquire and/or upgrade laboratory equipment
- Training of the laboratories' staff
- Set-up analysis, testing and/or quality control centers
- Engage in inter-comparison activities with other laboratories

### Certification

- Training of staff and human resources in general
- Acquire and/or upgrade equipment/instruments
- Set-up certification body

### Inspection

- Training of staff and human resources
- Acquire and/or upgrade equipment
- Establish inspection legislation

### Traceability

- Training in the field of traceability and/or about EU Traceability Regulations
- Acquire necessary equipment to undertake traceability activities
- Establish traceability legislation

## STATUS OF UNIDO INDUSTRIAL UPGRADING AND MODERNIZATION PROGRAMMES FORMULATION:

### West Africa:

The draft programme for upgrading was sent to ECOWAS/UEMOA secretariats and to EU on 5 October 2007. ECOWAS is translating the draft programme. The validation workshop is planned in the next few weeks in the field. The project document should be ready for signature in December 2007 or January 2008.

### Central Africa:

The draft programme for upgrading and quality infrastructure was sent to CEMAC/CEEAC secretariats and to EU on 15 October to EU. A presentation of the draft programme was made to the Task Force meeting organized on 23 October. The validation workshop in the field could be organized in the next few weeks. The project document should be ready for signature in December 2007 or January 2008.

### SADC:

Field mission finalized. The first draft programme for upgrading was sent to SADC secretariat and to EU in October. A first presentation of the draft programme was made to the Task Force meeting on 9 November. Validation seminar may be organized in the next few weeks and project document could be ready in December 2007/2008.

### COMESA:

Field mission finalized. The first draft programme for upgrading and quality infrastructure was sent to COMESA secretariat early November 2007. Validation seminar may be in December/January and project document should be ready by end of January.

### CARIFORUM:

ToR finalized and validated in August 2007. Close cooperation with CDE. Field mission started on 10 September. First progress report will be presented in January 2008. First draft UNIDO/CDE programme will be ready by end of January/February 2008. Validation seminar could be organized in February and programme document finalized in February/March 2008.

### PACIFORUM:

PACIFORUM secretariat agreed for UNIDO/CDE assistance in July 2007. Draft ToR with focus on SPS prepared and presented on 31 October in a meeting to PACP secretariat/EU. At the request of PACP, UNIDO assistance will focus on providing assistance in the SPS issues. A first action for strengthening capacities of SPS Competent Authorities is envisaged in February 2008. UNIDO may be involved in the implementation of the EU programme for “Strengthening Fish Products” SFP.

### Senegal: Restructuring and Upgrading Programme

The proposal of a restructuring and upgrading programme prepared by UNIDO, together with the ADEPME and AFD, affirms its ambition to assist Senegal integrating into the global economy, increase production, supply and the competitiveness of products, offer employment opportunities, increase investment and exports. This proposal is an important part of the strategy for Private Sector Development of the Senegal Government, which has been formulated by all the partners. The action plan for this strategy has also been adopted in inter-ministerial council on the 5th of June 2003. The technical assistance of UNIDO, which focuses on strengthening institutional capacities of Senegal, includes 8 activities/results and lasts for 4 years.

**Outcome of the programme**

- Over 200 enterprises participate in the programme;
- $ 44 million have been approved;
- So far 32 enterprises benefited with a total sum of $ 9,6 million;
- One technical support center has been upgraded;
- 45 enterprises received ISO 9001 certification;
- 160 experts received training on upgrading.

## 4. Experience and lessons learned

UNIDO has a long track record in implementing restructuring, upgrading and industrial competitiveness programmes. This has especially been proven in the framework of the Euro-Mediterranean Partnership. The Association Agreements have been launched in November 1995 and frame the trade relations between the EU and the neighbouring countries of the Mediterranean (Morocco, Algeria, Tunisia, Egypt, Jordan, Palestinian Authority, Israel, Lebanon, Syria). The Euro-Med countries enjoy duty free access to the EU market for manufactured goods but, similar to the EPAs, have to gradually reduce their manufacturing tariffs. Exports to the EU for Southern Mediterranean countries have doubled between 1995 and 2004, while imports from the EU to the Southern Mediterranean countries have increased by about 60%. UNIDO's upgrading and modernization programmes significantly contributed to this highly positive development.

UNIDO has developed a strong relationship through the years with bilateral and multilateral development partners. Concerning regional programmes, the main development partner at the moment has been the EC but the approach is gaining interest and other development partners may also provide assistance at this level. France (AFD) has already contributed to the UEMOA Regional Industrial Upgrading Programme and Norway to the African Economic Community Quality Programme. UNIDO and the EC have signed a Financial and Administrative Framework Agreement which has greatly facilitated the cooperation since its signature on 23 October 2003. The cooperation between UNIDO and the EC has been increasing regularly in the last few years and the EC may soon become UNIDO's main development partner.

UNIDO's assistance in this area also extends to non-ACP countries. In fact, similar programmes are under discussion with other countries and regional economic communities negotiating Association Agreements with the EU in Latin America (Andean Community, SIECA, MERCOSUR) and in Asia (SAARC, SEAN).

UNIDO has implemented/is implementing the following programmes, funded from the EU, OECD, AFD and other donors:

- Industrial upgrading programmes in MEDA countries: Algeria, Egypt, Morocco, Palestine, Syria and Tunisia (see box);
- Programme for upgrading and modernizing industry in Portugal following its accession to the EU in 1986;
- Senegal, as pilot programme, is currently benefiting from an upgrading programme (see box);
- In the area of quality infrastructure, a first Quality Programme was implemented from 2001 to 2005 in support of the UEMOA and its member States, in partnership with the EC. This programme has been extended in June 2007 to the 15 ECOWAS member States plus Mauritania through a partnership between UNIDO, UEMOA, ECOWAS and the EC.
- In the area of industrial upgrading and modernization a programme in December 2006 has been initiated in partnership between UNIDO, UEMOA and France (AFD).
- East Africa (Uganda, Tanzania, Kenya...): several others Trade Capacity Building programmes have also been implemented.

The boxes throughout the third Part of the paper give an impression of the successful implementation of the programmes.

**UEMOA/ UNIDO Strategic Partnership:**
**Building Productive capacities and supporting regional trade**

The cornerstone of UNIDO/West Africa fruitful partnership was the participation of UNIDO in the development of the UEMOA Industrial Common Policy (PIC). Since then UNIDO and UEMOA have built a solid and effective cooperation that culminated with the implementation of the famous UEMOA/UNIDO quality programme (EU funding: Euro 10 million). That programme is seen both in Africa and worldwide as a benchmark for regional integration projects in the field of quality, standards, certification and accreditation; how a regional group should integrate and streamline its activities to reduce duplication and to support economic development ensuring consumer protection.

In the frame of supporting industries in West Africa, UNIDO and UEMOA launched in June 2007 a second programme for Restructuring and Upgrading industries: the PRMN. This programme is funded through budgetary contribution to UEMOA by France (Euro 16 million).

UNIDO and the UEMOA mark another important milestone in their joint efforts to make UEMOA industry stronger, fit to face growing competition in domestic, regional and international markets, and able to become both an engine of growth and a mean to generate employment. This is once more an opportunity and a challenge to foster social and economic development and to reduce poverty in Africa.

A new regional quality programme for the UEMOA and ECOWAS was signed in June 2007 (Euro 14 million). UNIDO has partnered with the European Union and both the ECOWAS and the UEMOA region to jointly develop and implement an essential Trade Capacity Building programme.

This is a programme matching and complementary to the PRMN. Indeed, as UNIDO was selected as the executing agency for both of them, UNIDO will assure no waste of time and money but rather tangible and measurable successful results.

The private sector will be both the beneficiary and the key player in the implementation of both the PRMN and the quality projects. Those enterprises, which will be restructured and upgraded, shall be able to improve quality, and have access to internationally recognized quality, certification and testing services and tap new market opportunities. They will be assisted to increase quality and quantity of production and export. They will be able to increase their contribution to creation of wealth and employment opportunities: the only way out of the poverty trap for Africa.

## CONCLUSIONS

Time is an inherent problem concerning poverty in developing countries in general and ACP countries in particular. The deadline for signing Economic Partnership Agreements (EPAs) is approaching whereas the world economy is further gaining momentum. In fact, globalization and intensifying world competition are challenging ACPs goal to reverse the trend of trade marginalization, de-industrialization and unemployment in their countries. At the same time, the EU is stipulating trade agreements with other regions in the world, leading to ACP preference erosion. If ACP countries do not manage to become more competitive in the near future they will not be able to sell their products in their own region and on international markets, but instead suffer from increased import competition.

By the end of 2007 there should be a WTO-compatible trade agreement for all ACP regions although some countries do not yet see themselves in a position to sign full comprehensive EPAs. Time till then and the transitional period before complete tariff liberalization should be utilized effectively and efficiently for the implementation of accompanying measures. Strengthening productive and trade capacities, establishing adequate quality infrastructure and upgrading technical support institutions are of utmost importance for integrating ACP into the world economy and ensure the timely achievement of the Millennium Development Goals (MDGs).

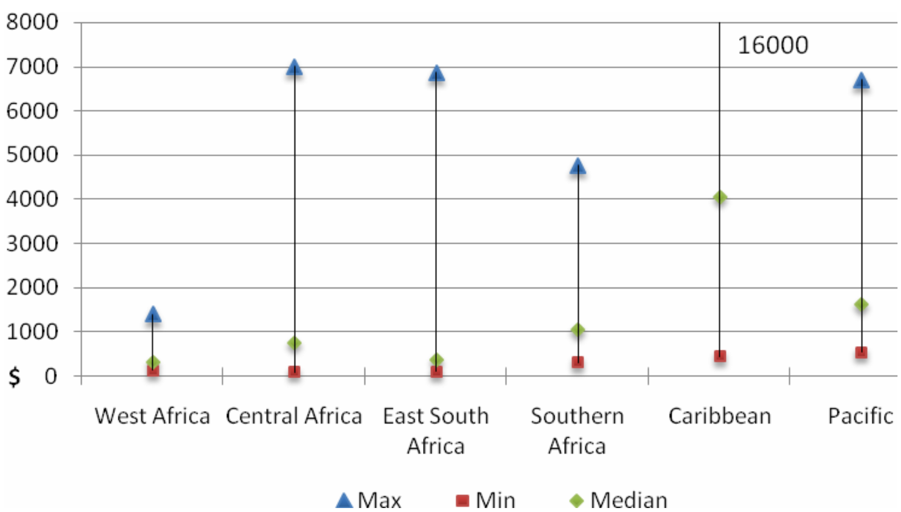
Concerning UNIDO's role in this context, its technical assistance in the thematic area of Trade Capacity Building is based on the "Aid for Trade" concept and on the three C's approach (Compete, Conform, Connect). The industrial upgrading and modernization programmes aim at improving all factors of competitiveness by providing capacity building at the enterprise and institutional level.

The technical know-how and experience that UNIDO has acquired in programme conceptualization and implementation in the field of building supply capacity and conformity infrastructure, together with the Organization's extensive field presence, are valuable assets in the context of EPAs. UNIDO stands ready to contribute to the efforts of the 6 regional economic communities, the EU, civil society and bilateral development partners to make EPAs a success for ACP countries in general and for its least developed countries (LDCs) in particular.

## ANNEX

The Annex aims at providing detailed analysis at the regional and at the country level for various sub-chapters. The location of Tables and Figures that can be found in the Annex are mentioned throughout the main text. Furthermore, an impact assessment of the EPAs for the 4 SSA regions concerning trade and fiscal effect are put in the Annex.

**Figure 1: GDP per capita in RECs**




Source: Own calculations, based on World Bank WDI, 2007. At constant 2000 prices.

**Table 1: Share of Manufacturing in GDP and Exports**

| Country | Manufacturing as share of | | Country | Manufacturing as share of | | Country | Manufacturing as share of | |
|---|---|---|---|---|---|---|---|---|
| | GDP | Exp | | GDP | Exp | | GDP | Exp |
| West Africa | 6,4 | | East South Africa | 9,6 | | Caribbean | 11,1 | |
| Benin | 8 | 13 | Burundi | 13 | 6 | Antigua & Barbuda | 2 | 29 |
| Burkina Faso | 14 | 8 | Comoros | 4 | 8 | Barbados | 7 | 43 |
| Cape Verde | 5 | 90 | Djibouti | 3 | | Belize | 9 | 13 |
| Gambia | 5 | 17 | Eritrea | 12 | | Dominica | 8 | 60 |
| Ghana | 9 | 12 | Ethiopia | 5 | 11 | Dominican Rep. | 15 | 34 |
| Guinea | 3 | 25 | Kenya | 11 | 21 | Grenada | 6 | 36 |
| Guinea Bissau | 12 | | Madagascar | 13 | 23 | Guyana | 10 | 20 |
| Côte d'Ivoire | 16 | 20 | Malawi | 12 | 16 | Haiti | 8 | |
| Mali | 10 | 55 | Mauritius | 20 | 70 | Jamaica | 14 | 66 |
| Mauritania | 4 | | Rwanda | 10 | 10 | St. Kitts & Nevis | 10 | 96 |
| Niger | 6 | 8 | Seychelles | 15 | 7 | St. Lucia | 5 | 36 |
| Nigeria | 4 | 2 | Sudan | 7 | 0,1 | St. Vincent | 5 | 25 |
| Senegal | 15 | 43 | Uganda | 9 | 17 | Suriname | 5 | 80 |
| Sierra Leone | 2 | 8 | Zambia | 12 | 9 | Trinidad & Tobago | 7 | 26 |
| Togo | 11 | 58 | Zimbabwe | 13 | 29 | | | |

| Country | Manufacturing as share of | | Country | Manufacturing as share of | | Country | Manufacturing as share of | |
|---|---|---|---|---|---|---|---|---|
| | GDP | Exp | | GDP | Exp | | GDP | Exp |
| Central Africa | 7,5 | | Southern Africa | 6,1 | | Pacific | 9,5 | |
| Cameroon | 19 | 3 | Angola | 3 | | Fiji | 16 | 25 |
| Central Afr. Rep. | 6 | 36 | Botswana | 4 | 86 | Kiribati | 1 | 9 |
| Chad | 1 | | Lesotho | 15 | | Palau | 0 | |
| Congo | 3 | | Mozambique | 13 | 7 | Papua New Guinea | 6 | 6 |
| Congo Dem. Rep. | 6 | | Namibia | 12 | 41 | Samoa | 16 | 77 |
| Equatorial Guinea | 0 | | Swaziland | 37 | 76 | Tonga | 5 | 5 |
| Gabon | 5 | 7 | Tanzania | 7 | 14 | Vanuatu | 4 | 8 |
| Sao T. & Principe | 3 | | | | | | | |

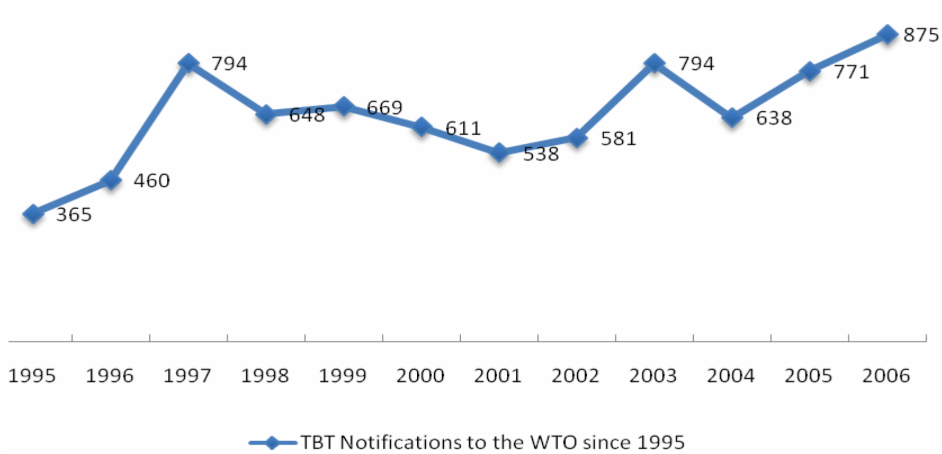
Source: Own calculations based on World Bank WDI, 2007

**Table 2: Biggest EPA countries in terms of total GDP**

| | Total GDP | Agriculture | | Industry - Man. | | Manufacturing | | Services | |
|---|---|---|---|---|---|---|---|---|---|
| | 2006 $ Mio | $ Mio. | % | $ Mio. | % | $ Mio. | % | $ Mio. | % |
| Nigeria | 113.816 | 25.609 | 22,5 | 56.794 | 49,9 | 4.211 | 3,7 | 27.202 | 23,9 |
| Angola | 47.260 | 3.166 | 6,7 | 26.513 | 56,1 | 1.607 | 3,4 | 15.974 | 33,8 |
| Sudan | 37.410 | 10.288 | 27,5 | 8.829 | 23,6 | 2.581 | 6,9 | 15.712 | 42,0 |
| Dominican Rep. | 30.581 | 3.774 | 12,3 | 4.147 | 13,6 | 3.881 | 12,7 | 18.654 | 61,0 |
| Kenya | 21.635 | 5.712 | 26,4 | 1.514 | 7,0 | 2.445 | 11,3 | 11.964 | 55,3 |
| Côte d'Ivoire | 17.273 | 3.869 | 22,4 | 1.935 | 11,2 | 2.764 | 16,0 | 8.706 | 50,4 |
| Cameroon | 16.648 | 3.413 | 20,5 | 2.164 | 13,0 | 3.080 | 18,5 | 7.991 | 48,0 |
| Ghana | 12.243 | 4.701 | 38,4 | 1.959 | 16,0 | 1.053 | 8,6 | 4.530 | 37,0 |
| Ethiopia | 12.150 | 5.856 | 48,2 | 996 | 8,2 | 632 | 5,2 | 4.653 | 38,3 |
| Tanzania | 11.811 | 5.421 | 45,9 | 1.181 | 10,0 | 827 | 7,0 | 4.370 | 37,0 |

Source: own calculations based on African Development Bank, 2007 and World Bank, WDI 2007

**Figure 2: TBT Notifications to the WTO since 1995**




Source: WTO, Twelfth annual review of the implementation and operation of the TBT agreement, G/TBT/21/Rev.1, 4 April 2007.

**Table 3: Tariff averages in ACP countries by EPA negotiating group**

| West Africa | Tot. | Agri | N-Ag | East South Africa | Tot. | Agri | N-Ag | Cariforum | Tot. | Agri | N-Ag |
|---|---|---|---|---|---|---|---|---|---|---|---|
| ECOWAS | | | | EAC | 12,7 | | | CARICOM | | | |
| WAEMU | | | | Kenya, Uganda | 12,7 | 19 | 11,7 | OECS | | | |
| Benin, Burkina Faso, Guinea Biss., Ivory Coast, Mali, Niger, Senegal, Togo | 12 | 14,3 | 11,6 | Burundi | 12,7 | 10,5 | 13,1 | Antigua, Barb | 9,7 | 15 | 8,9 |
| | | | | Comoros | 28,9 | 26,2 | 29,3 | Dominica | 9,9 | 20,4 | 8,3 |
| | | | | Djibouti | 28,1 | 21,7 | 29,1 | Grenada | 10,2 | 16,9 | 9,2 |
| | | | | Eritrea | 7,9 | 10 | 7,6 | St. Ch. & Nev. | 9,2 | 13,3 | 8,6 |
| | | | | Ethiopia | 16,8 | 17,3 | 16,7 | St Lucia | 8,9 | 14,8 | 8 |
| Cape Verde | 10,4 | 11,7 | 10,2 | Malawi | 13,5 | 14,7 | 13,3 | St Vincent | 9,8 | 15,6 | 8,9 |
| Gambia* | 12,7 | n.a | n.a. | Mauritius | 3,5 | 7,1 | 3 | Bahamas | 30,2 | 24,1 | 31,2 |
| Ghana* | 13,1 | n.a | n.a. | Madagascar | 13,3 | 14,7 | 13,1 | Barbados | 13,5 | 30 | 11 |
| Guinea | 11,9 | 14,6 | 11,5 | Rwanda | 18,7 | 14,6 | 19,4 | Belize | 10,8 | 20,7 | 9,3 |
| Liberia | n.a. | n.a | n.a. | Seychelles* | 28,3 | n.a. | n.a. | Guyana | 11,1 | 21,1 | 9,6 |
| Nigeria | 12 | 15,6 | 11,4 | Sudan | 20,1 | 30,6 | 18,5 | Haiti | 2,8 | 5,7 | 2,4 |
| Sierra Leone | 13,6 | 16,4 | 13,1 | Zambia | 13,9 | 18,8 | 13,2 | Jamaica | 7,3 | 17,2 | 5,8 |
| Mauritania | 10,7 | 12,4 | 10,5 | Zimbabwe* | 16,4 | n.a. | n.a. | Surinam* | 17,5 | n.a. | n.a. |
| | | | | | | | | Trinidad & Tob. | 7,8 | 15,8 | 6,6 |
| | | | | | | | | Dominican Rep. | 8,5 | 13,1 | 7,8 |

| Central Africa | Tot. | Agri | N-Ag | Southern Africa | Tot. | Agri | N-Ag | Pacific | Tot. | Agri | N-Ag |
|---|---|---|---|---|---|---|---|---|---|---|---|
| CEMAC | | | | Angola | 7,2 | 9,6 | 6,8 | Fed. Micron. | 4,5 | 4,6 | 4,5 |
| Cameroon, Centr. Afr. Rep., Chad, Gabon, Equat. Guinea | 18 | 22,1 | 17,4 | Botswana | 8 | 9,3 | 7,8 | Fiji | 10,2 | 25,7 | 7,8 |
| | | | | Lesotho | 7,9 | 9 | 7,8 | Kiribati | 17,5 | 24,9 | 16,3 |
| | | | | Mozambique | 12,1 | 16,4 | 11,4 | Palau | 2,9 | 2,7 | 3 |
| Congo Brazzav. | 18,4 | 22,6 | 17,7 | Namibia | 8 | 9,2 | 7,8 | Papua N. G. | 5,5 | 16,7 | 3,7 |
| Congo (Dem. Rep) | 12 | 12,8 | 11,9 | Swaziland | 8 | 9,3 | 7,8 | Solomon Is. | 14,5 | 17,5 | 14,1 |
| S. Tome, Princ | n.a. | n.a | n.a | Tanzania | 12,7 | 19 | 11,7 | Tonga | 17 | 25,3 | 15,8 |
| | | | | South Africa | 8 | 9 | 7,9 | Vanuatu | 16,3 | 33,2 | 13,8 |
| | | | | | | | | Cook Is., Marshall Is., Nauru, Niue, | n.a. | n.a. | n.a. |
| | | | | | | | | Tuvalu, Samoa | n.a. | n.a. | n.a. |

Source: WTO, ITC, UNCTAD; World Tariff Profiles 2006.
Those marked with a * are from Hinkle et al. (2005): "Beyond Cotonou: Economic Partnership Agreements in Africa". In: Trade, Doha, and Development: A window into the issues, Newfarmer, R. (ed.) Washington DC: The World Bank.

## Impact assessments by region

### *West Africa*

Busse et al.[62] studied the effects of a complete tariff liberalization that means the EPA effects after the transitional period and even then on 100% tariff cuts. They found out that trade creation exceeds trade diversion in all West African countries. In the mid-scenario setting, trade creation was between 3,6% of preferred imports in Mali and 12,5% in Nigeria. Trade diversion amounted to 1,1% of non-preferred imports in Guinea-Bissau and 7,6% in Nigeria. Total trade created would reach more than US-$ 1 billion in all West African countries. The increase would be highest in Nigeria with 20,8% of preferred imports equivalent to US-$ 577 million and can be explained by the fact that until now high trade barriers existed for EU imports.

Since import duties in ECOWAS countries can even reach 33 percent of total government revenue, and given that the EU is one of the major importers to the region, countries will possibly lose up to 80 percent of total import duties. This decline can account to 22 percent of total government revenue and as much as 3,5 percent of GDP (Gambia). Detailed results can be seen in Table 12.

**Table 4: EPA impact assessment for ECOWAS countries**

| Country (2001) | Trade creation | Trade diversion | Total trade effect | Import duties in % of total government revenue | Decline in import duties | |
|---|---|---|---|---|---|---|
| | % of preferred imports | % of non-preferred imports | % of preferred imports | | % of total government revenue | % of GDP |
| Benin | 7,6 | -3,2 | 11,6 | 18,1 | -8.6 | -1.16% |
| Burk. Faso | 5,7 | -3,2 | 9,7 | 12 | -5,6 | -0,71 |
| Cape Verde | 9,2 | -7,1 | 11,7 | 24,8 | -19,8 | -4,09 |
| *Côte d'Ivo.* | 6 | -2,9 | 8,2 | 8,2 | -4,6 | -0,8 |
| Gambia | 5,8 | -6,6 | 9,9 | 33,7 | -21,9 | -3,54 |
| *Ghana* | 3,7 | -2,4 | 6,9 | 15,5 | -10,3 | -1,82 |
| *Guinea* | 4,9 | -3,3 | 8,3 | 9,4 | -4,9 | -0,56 |
| Guinea-Biss | 4,5 | -1,1 | 5,2 | 8,5 | -5,6 | -1,09 |
| Mali | 3,6 | -1,3 | 5,9 | 10,7 | -3,8 | -0,63 |
| Mauritania | 5,5 | -2,8 | 8,6 | 12,8 | -6,3 | -1,17 |
| Niger | 4,9 | -1,5 | 8,6 | 12,3 | -3,6 | -0,34 |
| *Nigeria* | 12,5 | -7,6 | 20,8 | 4,7 | -2,5 | -1,19 |
| *Senegal* | 8 | -3,8 | 11,5 | 17,8 | -10,7 | -1,89 |
| Togo | 6,6 | -3,2 | 10,9 | 17,1 | -7,4 | -1,02 |

Source: data compiled from Busse et al. (2004), LDC's in Italic
Busse, M., A. Borrmann, and H. Großmann. (2004). "The Impact of ACP/EU Economic Partnership Agreements on ECOWAS Countries: An Empirical Analysis of the Trade and Budget Effects." *Institut für Wirtschaftsforschung*, Hamburg.

### *Central Africa*

In 2004 54% of total imports to Central Africa were coming from EU producers. CEMAC is therefore the region within the EPA negotiations with the highest EU import share. In

[62] Busse, M., A. Borrmann, and H. Großmann, "The Impact of ACP/EU Economic Partnership Agreements on ECOWAS Countries: An Empirical Analysis of the Trade and Budget Effects." *Institut für Wirtschaftsforschung*, Hamburg, 2004.

combination with high MFN tariffs in that region, the simple average being 18% for CEMAC, it should lead to high revenue losses, if government's there rely mostly on import duties.

UNECA[63] estimated trade creation and trade diversion effects in absolute terms, as well as the revenue and welfare implications.

Central Africa would increase trade substantially with the EU under EPAs, mainly in Cameroon, Congo Republic and Gabon. The total trade effect in Central African Countries would amount to US-$ 650 million. According to the study however, regional integration would rather be undermined, since trade would be diverted away from countries within Central Africa. This urges the need for additional Aid for Trade disbursements, in order to dampen the shock resulting also from government revenue shortfalls. An overview of Central African decline in import duties as a result of EPAs can be seen in Table 13 in the Annex.

**Table 5: EPA impact assessment for Central African countries**

| Country | Trade creation in Mio US-$ | Net Trade diversion (Mio $) | Revenue Shortfall in Mio US-$ | Consumer Surplus in Mio US-$ |
|---|---|---|---|---|
| Cameroon | 255,43 | -26,57 | -149,26 | 30,26 |
| Congo Republic | 123,71 | -20,48 | -75,10 | 16,05 |
| Gabon | 126,49 | -27,69 | -74,30 | 16,11 |
| *Equat.Guinea* | 53,29 | -5,39 | -33,91 | 6,23 |
| *Central Afr. Rep.* | 8,23 | -1,25 | -5,84 | 1,05 |
| *Chad* | 40,73 | -5,94 | -26,68 | 4,35 |
| *Dem. Rep. Congo* | 45,39 | -6,84 | -24,69 | 10,89 |

Source: data compiled from UNECA (2005), LDC's in Italic
UNECA (2005). "Economic and Welfare Impacts of the EU-Africa Economic Partnership Agreements." ECA/TRID; available at http://www.uneca.org/atpc/Work%20in%20progress/10.pdf.

### *Southern Africa*

In a recent study conducted by Borrmann et al.[64], the implications of the abolishment of MFN tariffs for the EU have been ascertained. Again, the partial equilibrium model has been used with 2003 as a base year.

Average tariffs in Southern Africa are among the lowest in ACP countries, as a result of recent MFN liberalization. For the Southern African Customs Union (SACU)[65] non-agricultural tariffs are at 7,8% and 6,8% in Angola, 11,4% in Mozambique and 11,7% in Tanzania. Almost half of Angola's imports are from the EU, while having a non-agricultural tariff in average of 6,8%. Moreover, non-tariff barriers have been reduced or eliminated and other trade reforms initiated.

Trade and budget effects resulting from a 100% cut of tariffs can be seen in Table 14 in the Annex. Total increase in EU exports to Southern African countries will amount to US-$ 177 million or 7,8% of preferred imports. Total trade creation is estimated at US-$ 121 million (5,3%) and will be highest in Swaziland with an increase of 8%, lowest in Lesotho with 2,4%. Trade diverted away from non-EU exporters will amount to US-$ 56 million (-0,8%), with maximum 2% of non-preferred imports in Angola. Trade creation is therefore larger than trade diversion in all countries.

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63 "Economic and Welfare Impacts of the EU-Africa Economic Partnership Agreements." ECA/TRID, 2005.
64 Borrmann, A., Busse, M., and de la Rocha, M. "Consequences of Economic Partnership Agreements between East and Southern African countries and the EU for inter- and intra-regional integration, *Hamburg Institute of International Economics (HWWI), Research Paper 2-8*, 2007
65 Members are South Africa, Botswana, Lesotho, Namibia and Swaziland

Compared to the two previous regions, trade effects are rather small. This is due to the already low level of MFN tariffs. Furthermore competition intensities at the product level, import structures and tariff collection efficiency ratios may also play a role.

Declines in import duties as a share of total government revenue vary between 0,1% (Lesoto) and 3,3% (Mozambique). In absolute terms and as a share of GDP, Angola will be the main loser, with a loss of US-$ of 88 million and 0,8 % of GDP.

To sum up, in the Southern African region government losses will be manageable. The median decline as a share of GDP will only be 0,1%, while in the West African region it was one percentage point more.

**Table 6: EPA impact assessment for South African countries**

| Country | Imports from EU | Trade creation | Trade diversion | Total trade effect | Import duties in % of total gov.ment revenue | Decline in import duties | |
|---|---|---|---|---|---|---|---|
| | % of total imports | % of preferred imports | % of non-preferred imports | % of preferred imports | | % of total government revenue | % of GDP |
| *Angola* | 49,7 | 5,2 | -2,0 | 7,3 | 3,6 | -2,0 | -0,8 |
| Botswana | 9,0 | 3,1 | -0,2 | 5,1 | 6,4 | -0,2 | -0,1 |
| *Lesotho* | 7,4 | 2,4 | -0,1 | 3,6 | 5,7 | -0,1 | -0,03 |
| *Mozambique* | 22,9 | 5,4 | -0,7 | 7,9 | 15,4 | -3,3 | -0,5 |
| Namibia | 6,0 | 3,8 | -0,2 | 6,7 | 15,6 | -0,4 | -0,1 |
| Swaziland | 1,0 | 8,5 | -0,1 | 13,7 | 24,1 | -0,3 | -0,1 |
| *Tanzania* | 19,6 | 6,6 | -0,9 | 10,3 | 24,9 | -5,5 | -0,3 |

Source: data compiled from Borrmann et al. (2007); LDC's in Italic
Borrmann, A., Busse, M., and de la Rocha, M. (2007). "Consequences of Economic Partnership Agreements between East and Southern African countries and the EU for inter- and intra-regional integration, *Hamburg Institute of International Economics (HWWI), Research Paper 2-8*, 2007

### *East and Southern Africa (ESA)*

Total trade creation for the ESA region[66], varies between US-$ 295 million according to Borrmann et al. (2007) and to US-$ 727 million according to Karingi et al. (2006). Trade diverted away from more efficient non-EU supplier reach US-$ 144 million and US-$ 234 million. As a result, the EU could increase their levels of trade by up to 840 million US-$ or 440 million US-$. The differences in the outcome of the two studies analyzed arise among other reasons from using different base years and thus different data as.

Trade creation varies between 2,6 percent in Madagascar and 13,5 percent of preferred imports in Burundi. The low trade increase in Madagascar is a result of a low import-weighted tariff rate for calculations[67]. Trade diversion ranges between 0,7% for Zimbabwe and 8,1% for Comoros of non-preferred imports. Comoros is the only country whose nominal trade creation will exceed trade diversion and therefore result in a negative trade effect (see Table 15 in the Annex).

The EU is an important component of East and South African customs fiscal base, since 28% of total imports are originating there. The losses of fiscal revenues can therefore be substantial. Borrmann et al. (2007) found out that the whole ESA region would lose almost US-$ 380 million of trade taxes (Table 16 in the Annex). Nominal declines will be, of course,

[66] Leaving out Eritrea for which data was not available
[67] 3,2% used for calculation while today it is at 9,3%

higher for countries with already high nominal amounts of import from the EU. More interestingly are the lost percentages. Again, a combination of high import-weighted tariff rates, high shares of imports from the EU and high dependence on import duties lead to high percentages decline in government revenue and GDP. As a consequence, Comoros for example would almost lose a quarter of their government revenue and 3,9% of GDP, putting severe pressure on the country to retain the lost share elsewhere.

**Table 7: EPA impact assessment for ESA countries (trade effects)**

| Country | Trade creation | | | Trade diversion | | | Total trade effect | | |
|---|---|---|---|---|---|---|---|---|---|
| | Mio \$ a) | Mio \$ b) | % | Mio \$ a) | Mio \$ b) | % | Mio \$ a) | Mio \$ b) | % |
| *Burundi* | 12,4 | 5,3 | 13,5 | -1,6 | -1,5 | -2,9 | 13,9 | 6,8 | 17,5 |
| *Comoros* | --- | 3,6 | 10,1 | --- | -3,8 | -8,1 | --- | 7,4 | 20,7 |
| *Djibouti* | 56,5 | 12,7 | 8,8 | -9,6 | -4,7 | -1,6 | 66,0 | 17,5 | 12 |
| *Ethiopia* | 120,1 | 37,2 | 7,7 | -31,2 | -16,9 | -1,5 | 151,8 | 54,1 | 11,2 |
| Kenya | 211,3 | 57,8 | 5,7 | -60,5 | -28,4 | -1,4 | 27,2 | 86,2 | 8,5 |
| *Madagascar* | 16,6 | 4,1 | 2,6 | -4,1 | -1,8 | -0,5 | 20,6 | 5,9 | 3,7 |
| *Malawi* | 15,1 | 4,3 | 5,2 | -6,5 | -3,9 | -0,8 | 21,7 | 8,2 | 9,8 |
| Mauritius | 166,9 | 54,7 | 9,3 | -44,7 | -25,8 | -1,6 | 211,7 | 80,5 | 13,6 |
| *Rwanda* | 10,6 | 4,4 | 6,5 | -3,1 | -2,2 | -1,2 | 13,6 | 6,6 | 9,8 |
| Seychelles | 25,3 | 10 | 13,4 | -2,7 | -2,1 | -1,2 | 28,1 | 12,2 | 16,3 |
| *Sudan* | 119,6 | 61,5 | 12,8 | -33,5 | -29,2 | -3,7 | 153,1 | 90,7 | 18,9 |
| *Uganda* | 19,2 | 8,8 | 3,4 | -9,0 | -5,6 | -0,5 | 28,2 | 14,3 | 5,6 |
| *Zambia* | 31,7 | 14,3 | 5,9 | -10,4 | -8 | -0,8 | 42,1 | 22,2 | 9,2 |
| Zimbabwe | 45,6 | 17,2 | 9,1 | -17,6 | -10,5 | -0,7 | 63,2 | 27,7 | 14,6 |

Source: a) Karingi et al. (2005)
b) Borrmann et al. (2007)
LDC's in Italic

**Table 8: EPA impact assessment for ESA countries (fiscal effects)**

| Country | Import duties as % of total revenue | Decline in Import Duties | | | | | |
|---|---|---|---|---|---|---|---|
| | | Mio US-\$ | % ot total import duties | % of total government revenue | *) | % of GDP | *) |
| Burundi | 10,9 | -6,6 | -44,6 | -4,8 | -6,9 | -0,9 | -1,6 |
| Comoros | 46,8 | -8,6 | -52,4 | -24,5 | -6,3 | -3,9 | -1,6 |
| Djibouti | 37,5 | -18,6 | -37,3 | -14,0 | --- | -3,1 | --- |
| Ethiopia | 11,7 | -44,6 | -31,7 | -3,7 | --- | -0,7 | --- |
| Kenya | 6,1 | -69,5 | -33,0 | -2,0 | -7,7 | -0,6 | -0,6 |
| Madagascar | 2,2 | -4,2 | -41,1 | -0,9 | -1,9 | -0,1 | -0,2 |
| Malawi | 11,3 | -5,2 | -14,2 | -1,6 | -3,3 | -0,3 | -0,6 |
| Mauritius | 23,6 | -76,5 | -39,3 | -9,3 | -11,8 | -1,7 | -1,8 |
| Rwanda | 5,9 | -4,9 | -36,4 | -2,2 | -10,2 | -0,3 | -0,8 |
| Seychelles | 18,8 | -18,6 | -46,2 | -8,7 | --- | -3,1 | --- |
| Sudan | 12,4 | -76,4 | -34,6 | -4,3 | --- | -0,6 | --- |
| Uganda | 8,7 | -9,7 | -14,7 | -1,3 | -0,7 | -0,2 | -0,2 |
| Zambia | 11,1 | -15,6 | -16,5 | -1,8 | -4,0 | -0,4 | -0,5 |
| Zimbabwe | 6,4 | -20,6 | -15,3 | -1,0 | --- | -0,2 | --- |

Source: Data compiled from Borrmann et al. (2007)
Except fields marked with *) are from Khandelwal (2004)
Khandelwal, P. (2004), "COMESA and SADC: Prospects and Challenges for Regional Trade Integration", *IMF Working Paper, WP/04/227*, December 2004

## HOW TO DEAL WITH THE REVENUE CONSEQUENCES OF EPAS

In OECD countries total tax revenues amount to 40% of GDP with a negligible small part of trade tax while in Sub-Saharan Africa it is in average 16% of GDP of which 4% trade tax.

Tariff taxes have to be replaced by income taxes and domestic consumption taxes consisting in a general sales tax, like the value-added tax (VAT), and excises on imports[68].

What should ACP countries undertake in view of a pro-development EPA and in order to successfully replace trade tax revenue by domestic sources, despite weak administrative capacities in their countries?

- First of all authorities have to be honestly committed to change a situation. It could be that single countries, hoping for increased Aid for Trade commitments from the EU and other donors, will not undertake any initiatives to recover taxes. They might rather be tempted to choose a “wait and see” strategy;
- The mere introduction of a VAT is not a guarantee for complete tax recovery. But as data shows, ACP countries who managed to maintain their former tax revenue levels, were able to mobilize domestic tax sources. Furthermore, excises could also play a key role in the transition period;
- Revenue recovery of domestic VAT collection depends on the proper design and implementation in ACP countries. A simple, broad-based VAT should be envisaged. In Senegal, a single rate with few exemptions has to be proven to work well. Where revenue administration is weak, Aid for Trade amounts should be utilized to improve it;
- The tax base has to be broadened in order to mitigate the adverse effects of an EPA. This should not only be done by passing the burden to domestic consumption taxes, but also by strengthening income tax revenues;
- Collection efficiency ratios for trade taxes, being the percentage of the collection ratio of import-weighted tariff rates, have to be increased. In ESA for example, they vary between 42 and 88 percent. This could be done within a tax administration reform by harmonizing tariff structures, reducing exemptions, and, fight corruption and smuggling.

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[68] IMF, “Dealing with the Revenue Consequences of Trade Reform. Background Paper for Review of Fund Work on Trade.”, 2005.

**Table 9: Characteristics and Trade Data of Regional Groupings**

| Country Information | ACP | per capita | West Africa | per capita | Central Africa | per capita | ESA | per capita | SADC group | per capita | Caribbean | per capita | Pacific | per capita |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| population in 1000p : | 705.833 | | 260.075 | | 89.840 | | 263.047 | | 76.352 | | 24.107 | | 7.744 | |
| GDP (current m. $): | 374.253 | 530 | 130.613 | 502 | 41.829 | 466 | 81.907 | 344 | 54.411 | 713 | 56.382 | 2.339 | 8.194 | 1.058 |
| Debt (current mo $) : | 180.417 | 256 | 60.633 | 233 | 27.869 | 310 | 44.016 | 185 | 14.331 | 188 | 27.756 | 1.151 | 3.095 | 400 |
| FDI, net inflows(current $) | 11.479 | 16 | 2.211 | 9 | 2.908 | 32 | 2.001 | 8 | 2.171 | 28 | 2.047 | 85 | 141 | 18 |
| ODA and official aid (current $) : | 13.473 | | 3.840 | | 1.038 | | --- | | 2.658 | | 553 | | 641 | |
| EU Trade in goods with ... | | | | | | | | | | | | | | |
| exports (in m. €) | 30.619 | 43 | 13.482 | 52 | 3.421 | 38 | 5.335 | 22 | 3.121 | 41 | 4.681 | 194 | 568 | 73 |
| imports (in m. €): | 36.077 | 51 | 13.764 | 53 | 5.393 | 60 | 4.400 | 19 | 7.450 | 98 | 3.823 | 159 | 1.245 | 161 |
| trade balance(in m. €) | -5.457 | | -282 | | -1.972 | | 935 | | -4.329 | | 858 | | -678 | |
| Agriculture represents | | | | | | | | | | | | | | |
| Exports (in %) | 12% | | 14% | | 15% | | 9% | | 15% | | 9% | | 2% | |
| Imports (in %) | 24% | | 23% | | 10% | | 63% | | 11% | | 24% | | 34% | |
| Participation in EU Trade (in %) | | | | | | | | | | | | | | |
| Exports | 2,85% | | 1,25% | | 0,32% | | 0,50% | | 0,29% | | 0,44% | | 0,05% | |
| Imports | 3,05% | | 1,16% | | 0,46% | | 0,37% | | 0,63% | | 0,32% | | 0,11% | |
| Primary Products | | | | | | | | | | | | | | |
| Exports | 4,20% | | 5,30% | | 5,00% | | 5,00% | | 2,70% | | 1,20% | | 0,30% | |
| Imports | 67,7% | | 81,80% | | 79,70% | | 47,40% | | 81,50% | | 13,70% | | 14,10% | |
| ... Trade in Goods with the World | | | | | | | | | | | | | | |
| Total exports (in m.€) | 96.738 | 137 | 41.510 | 160 | 11.306 | 126 | 12.283 | 52 | 10.791 | 141 | 16.083 | 667 | 4.571 | 590 |
| Total imports (in m. €) | 102.207 | 145 | 38.358 | 147 | 5.602 | 62 | 19.782 | 83 | 9.576 | 125 | 25.542 | 1.060 | 2.937 | 379 |

Source: Own calculations based on COMEST 2005 EU declarations and IMF 2004 data