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THE COTONOU AGREEMENT
SELECTED ISSUES, EFFECTS AND IMPLICATIONS
FOR CARIBBEAN ECONOMIES

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Executive summary

This document analyses selected issues, effects and implications of the Cotonou Agreement (Cotonou, Benin, 23 June 2000) on Caribbean economies with a focus on Caribbean Community (CARICOM) countries.

The Cotonou Agreement replaces the Lomé agreement which provided the framework for trade and cooperation between the European Union (EU) and African Caribbean and Pacific (ACP) States since 1975. It overhauls the trade relations between both.

The main objective of the new partnership agreement is the ‘eradication of poverty in a consistent manner with the objectives of sustainable development and the gradual integration of the ACP countries in the world economy’. The agreement comprises four distinguishing features. First, it incorporates the political dimension in the negotiations. Second, it envisages a participatory approach incorporating the different sectors of society in the consultative and decision-making process. Third, it places a strengthened focus on poverty reduction through social and economic development and the deepening of regional integration. Fourth, it overhauls the principle of non-reciprocity which formed the basis for trade relations in the Lomé conventions.

With the Cotonou Agreement, ACP countries have agreed to turn their non-reciprocal trading arrangement with Europe into fully reciprocal regional integration areas in the form of Economic Partnership Agreements (EPA). ACP countries launched negotiations for EPA in September 2002.

The Caribbean region and the EU started the EPA negotiations in April 2004. The EU and CARIFORUM (CARICOM plus the Dominican Republic) are the negotiating partners. CARICOM’s Regional Negotiating Machinery (RNM) negotiates on behalf of CARIFORUM. The EPAs timetable includes four phases and both trading partners are about to embark on the third phase of the negotiation.

The progressive dismantling of trade barriers and preferences will further integrate ACP countries into the multilateral system and make the EU-ACP trade relation World Trade Organization (WTO) compatible. In this sense the Cotonou Agreement argues that the move towards a free-trade area will bring benefits, such as the benefit of cheaper EU imports, but it also recognizes that the ACP States may also have to face major challenges. At the same time, the implementation of the Cotonou Agreement may have significant economic and social impacts.

The EU applies very low or zero tariffs on most of its imports from ACP countries so that the effect of the removal of trade barriers on the external sector or for fiscal performance is bound to be modest. In other words the costs of trade liberalization for the EU are minor.

Contrarily ACP States will have to face the full force of global competition. As a result they must use the preparatory period to modernize their economies and become more

competitive. The transformation of their economies will require major adjustment costs in some cases. To address the challenges and constraints the ACP countries have to face, it is crucial to combine trade and economic policies with social development policies. From the point of view of the agreement, this should lead to economic growth and eventually poverty reduction.

The timetables for trade liberalization and the scope of trade liberalization have not yet been negotiated. As a result the measurement of the effects of EPAs can only be a tentative and very preliminary exercise. ACP countries have, however, expressed concerns about the effects of trade liberalization. The validity of these concerns has been recognized by the EU and by some of the impact studies that have been undertaken.

These include the loss of export earnings due to the erosion of trade preferences, the potential increase in imports due to the decline in tariffs, the vulnerability of some sectors to increased competition including not only the agricultural but also the manufacturing sector. In addition the potential costs of job losses and the social dislocation have also been pointed out as potential negative effects of EPAs.

At the same time EPAs are expected to induce greater flows of foreign savings. If properly channeled, a greater level of foreign savings may result in expanding productive capacity leading to a higher level of economic growth. A greater level of foreign savings would soften the external constraint and growth would allow the expansion of government revenue.

From the point of view of this document EPAs will have three important effects on CARICOM economies.

First, they will provide an incentive for CARICOM to accelerate and perfection its regional integration process. Regional integration is seen as a pre-condition for extraregional integration. The region can be a training ground for firms to become competitive at the extraregional level.

Second, the EPAs will accentuate the economic tendencies that are entrenched in CARICOM. These include the stagnation of agriculture, the virtual disappearance of the manufacturing sector in some of the smaller States and the continued dynamism of the services sector. EPAs should ensure that their provisions do not lead to a process of economic duality, marginalisation of the traditional sectors of the economy, and annihilation of the manufacturing sector.

Third, the EPAs will also provide an opportunity for CARICOM countries to restructure or to continue to restructure their economies to adapt to a changing environment. Firms in the Caribbean have begun a process of restructuring production aimed at reducing costs. Firms expect to achieve a reduction in costs via; (i) the expansion of their installed capacity; (ii) a change in the methods of production; and (iii) diversification in their product lines.

The document is structured in seven sections. The first section describes the origins of the Cotonou agreement. The second section addresses the main traits and mentions its five pillars. The third section focuses on the protocols and more specifically on the sugar and banana

protocols. The fourth section centers on the negotiations between CARIFORUM and the European Union. The fifth section focuses on Europe's Outermost Regions in the Caribbean and the Overseas Territories and Countries in the region that constitutionally depend on a member State of the European Union. The sixth section analyses the trade flows in goods and services between the Caribbean and the European Union focusing on the exports of CARICOM to the European Union as well as on the market for Caribbean imports. The last section ascertains the potential impact of the EPAs using static and dynamic analysis.

1. Introduction

From 1975 until 2000 the Lomé Convention provided the framework for trade relations and cooperation between the European Union and former colonies of its member States that gained independence after World War II. These newly independent countries benefited from duty-free access to the European market for a number of export products from African, Caribbean, and Pacific States (ACP) on a non-reciprocal basis. In 2000, the Lomé Convention was replaced by the Cotonou agreement, named after the city in Benin where the agreement was reached.

The Cotonou agreement aims to “promote and expedite the economic, cultural and social development of the ACP States, with a view to contributing to peace and security and to promoting a stable and democratic political environment”. It envisages four broad areas of support and spells out new orientations regarding economic and trade cooperation.

A key objective is to integrate the beneficiary countries into the global economy. Non-reciprocal trading arrangements will gradually be replaced by fully reciprocal integration areas in the form of regional Economic Partnership Agreements (EPAs) which also provide for supporting initiatives in a several broad areas. The EPAs would form the basis for the establishment of a free trade area with the European Union (EU). ACP countries launched the EPA negotiations in September 2002 and CARIFORUM began the regional negotiations for the Caribbean in 2004. The EPAs timetable includes four phases. Presently CARIFORUM is about to embark on the third phase of the EPA negotiations, with the objective of arriving at elements of a draft agreement by December 2006.

In the opinion of the negotiating parties, the move towards a free trade area with the European Union will bring benefits to ACP countries. The negotiating parties, especially ACP countries, understand the need to change the practices that have guided trade relations in the past three decades. At the same time they recognize that ACP countries will face important economic and social challenges especially those derived from the reform of the Protocols.

Although the agreement aims to improve the insertion of ACP countries in the global economy and several areas of cooperation are directly oriented to stimulate exports through investment promotion and business development, the new trade regime contained in the EPA is bound to also have negative effects on export revenue as Caribbean exports face the erosion of trade preferences. Another likely effect is the increase in imports following a decrease in tariffs. The implications for the balance of payments are uncertain. The agreements may also have negative consequences for fiscal revenues, through tariff reductions and the narrowing of the tax base. Moreover, erosion of trade preferences and enhanced competition on domestic markets may affect employment.

This document analyses selected issues, effects and implications of the Cotonou agreement on Caribbean economies.

The document is structured in seven sections. The first section describes the origins of the Cotonou agreement. The second section addresses the main traits and mentions its five pillars

(the political dimension, the participatory approach, a strengthened focus on poverty reduction, development cooperation, trade and economic cooperation and financial aid).

The third section focuses on the protocols and more specifically on the sugar and banana protocols. It provides a description of the background to the protocols and a brief overview of the importance of sugar and bananas for Caribbean economies.

The fourth section centers on the negotiations between CARIFORUM and the European Union. It describes the status of the negotiations and examines the underlying differences in the approach taken by CARIFORUM and Europe.

The fifth section focuses on Europe's Outermost Regions in the Caribbean and the Overseas Territories and Countries in the region that constitutionally depend on a member state of the European Union. The section explores the possible impacts of a Caribbean Cotonou Agreement for these countries and the issues for EPA negotiations related to Caribbean integration and collaboration.

The sixth section analyses the trade flows of goods and services between the Caribbean Community (CARICOM) and the EU the analysis is undertaken at the aggregate and country level. This section also comprises an analysis of competitiveness of CARICOM exports to the European Union using the software Competitive Analysis of Nations (CAN).

The last section ascertains the potential impact of the tariff reduction scenarios contemplated by the EPAs using a static model, the SMART methodology, and a dynamic model, the Balance-of-payments constrained model (BPC model). The SMART methodology views the impact of tariff reduction on trade creation and trade deviation. The BPC model determines the impact of tariff reduction and export growth on the equilibrium rate of growth of selected Caribbean economies.

2. The origins of the Cotonou agreement

The cooperation between the EU and the ACP started with the Yaoundé Convention (1963 and 1969). It defined the way in which former European colonies were to be incorporated in the Community Policy established by the Treaty of Rome.

The inclusion of the United Kingdom into the EU and of its former colonies led to the overhaul of the Yaoundé Convention. Yaoundé was replaced by four successive Lomé Conventions, which provided the framework for trade and cooperation between the EU and ACP States from 1975 to 2000. The first Lomé Convention (1975) granted non-reciprocal market access for 84% of ACP countries' agricultural exports to the EU, a stabilization mechanism for export prices (STABEX) and financial, technical and industrial cooperation mechanisms. The three Lomé Conventions that followed (1980, 1984 and 1989, respectively) amplified and expanded the scope of cooperation and asymmetrical treatment granted to ACP countries¹ (See Box 3 in the Annex).

¹ The first Lomé convention was signed in 1975. There followed Lomé II, Lomé III and Lomé IV signed in 1980, 1984, and 1989 respectively. Between 1975 and 1995, the number of beneficiary increased from 45 to 70. It should be noted that while the Lomé

Central to the spirit of the Lomé Conventions was the incorporation of special protocols that provided free market access at guaranteed prices for selected ACP agricultural products (sugar, beef, rum and banana) to the European market. The protocols reflected the central role that the Lomé Conventions attributed to raw materials. Their provisions were meant to offset the effects of the protectionist measures (quantitative restrictions and other measures) granted by the Common Agricultural Policy (CAP) to European agricultural products.

This model of cooperation between the EU and ACP countries became at odds with the global trend of trade liberalization and the strengthening of a multilateral approach, especially with the creation of the World Trade Organization (WTO). The generally poor performance of ACP countries was another strong reason for overhaul of the model. The deepening and widening of European integration, including the revision of the Treaty in 2001, finally made thorough revision a matter of urgency.

The acceptance of free trade coincided with a wealth of empirical evidence accumulated since the 1970s highlighting the virtues of outward relative to inward oriented integration² and was reflected in the Uruguay-General Agreement on Trade and Tariff (GATT) Round of negotiations and commitments (1986-1994).

Following the Uruguay Round, the distinction between developed and developing economies became framed in terms of ‘adjustment costs’ (Fukasako, 2000). Developing countries had greater adjustment costs than developed countries in complying with the rules of an international trade body. The emphasis on free trade and adjustment costs signaled a clear move away from non-reciprocity, which was a fundamental principle of the Lomé Conventions.

Paraphrasing Michalopoulos (2000), the most fundamental change brought about by the Uruguay Round was to replace the exception to reciprocity granted to developing economies with the recognition that there are adjustment costs for these economies, but that these must be dealt with ‘within reciprocity.’³

The performance of ACP countries also emerged a source of concern during the Lomé IV period and was clearly highlighted in the European Commission’s Green Paper (1986).

Lomé IV recognized that the debt situation of ACP countries had worsened and viewed aid as an obstacle to development and economic reform (Tamames, 1996). As a result, the European Community tied a portion of its financial aid to the undertaking and implementation of structural reform.

Convention is non-reciprocal; ACP States cannot discriminate among EU member States. In other words, any benefits relating to tariffs or non-tariff barriers granted by a member State of the EU to an ACP State must be granted to similar imports from the other EU member States (OAS, 1996 p. 58).

² The standard work cited in this literature is I. Little, T Scitovsky, M Scott, *Industry and Trade in Some Developing Countries: A Comparative Study* (1970).

³ Perhaps the general acceptance of this viewpoint was also influenced by the perception that a multilateral trade agreement such as GATT could favor the interests of developing economies. The Uruguay Round strengthened the dispute settlement mechanism, extended the coverage of trade negotiating areas (agriculture and textiles) and widened the market access to developed country markets through the elimination of voluntary export restraints.

The European Community's Green Paper went further and questioned the effectiveness of aid and, more generally, the foundations of asymmetrical treatment in trade relations.

The Green Paper asserted the difficulty of assessing the impact on a country's social and economic conditions. In particular it argued that the impact of aid was highly dependent on the internal conditions of countries.⁴ Nonetheless, it stated in clear terms that domestic policy reform was a pre-condition for aid-effectiveness:

Even though a great number of projects financed by the Union have proved positive and effective...they have not automatically led to improvements in the country's development indicators. Without incentive policies, dynamic sectoral institutions and sufficient funding to cover operating and maintenance costs, the viability of aid remains precarious. This fact is reflected by a tendency for international aid to focus on the countries that seem best able to use it effectively, which at the moment are those undergoing structural adjustment. (Chapter II, p.12).

In respect of asymmetrical treatment, the Green Paper emphasized that trade preferences did not improve ACP countries export performance. During the Lomé Conventions, ACP market share declined from 7% in 1976 to 3% in 1998 (Barthe, 2003, p.65). In addition, leaving aside a few success stories, countries did not manage to diversify exports.

The underlying explanation included the existence of binding supply constraints, dependency on commodities that are subject to high price fluctuations, and the deterioration of the terms of trade. Most important the poor export performance was due to the absence of 'sound' domestic policies. Sound domestic policies included among others, macroeconomic stability, realistic and stable exchange rates, good institutions and governance, stable and credit import and taxation regimes, and reduced trade protection (EU, Green Paper, 1996, pp.17-18).

The Cotonou agreement (2000) replaces the Lomé agreement and is valid for a period of 20 years with periodic revisions every five years. The Cotonou agreement overhauls the trade relations between the European Community and ACP States. Contrary to the Lomé 'spirit', The Cotonou agreement envisages trade relations founded upon the progressive dismantling of trade barriers and preferences integrating ACP countries into the multilateral system and making the European Union-ACP trade relation WTO compatible. Also, the ACP-wide approach is abandoned for region-specific agreements which bring into focus the objective of strengthening regional economic integration among groups of ACP-countries and with their neighbouring economies.

3. The main traits of the Cotonou agreement

The main objective of the new partnership agreement is the 'eradication of poverty in a consistent manner with the objectives of sustainable development and the gradual integration of

⁴ As put in the Green Paper (Chapter II, p.12): "... the institutional and economic policy situation in the recipient countries has been a major constraint, reducing the impact of aid operations."

the ACP countries in the world economy.⁵ The agreement comprises four distinguishing features. First, it incorporates the political dimension in the negotiations. Second, it envisages a participatory approach incorporating the different sectors of society in the consultative and decision-making process. Third, it places a strengthened focus on poverty reduction through social and economic development and the deepening of regional integration. Fourth, it overhauls the principle of non-reciprocity which formed the basis for trade relations in the Lomé conventions (See Box 4 in the Annex).

The political dimension plays a pivotal role in the Cotonou agreement since the partnership includes a number of wide issues ranging from economic and social issues to peace building, conflict prevention and resolution matters. Partners in the agreement agree to 'regularly engage in a comprehensive, balanced and deep political dialogue leading to commitments on both sides.'⁶ The dialogue can take place in formal or informal settings and at different geographical levels to ensure its continuity and flexibility.⁷

Some of the issues addressed in the Partnership such as the respect for human rights, democratic principles and the rule of law were emphasized in the revised Lomé IV Convention. Nevertheless, an essential new element, which underpins the partnership is good governance, and in particular the fight against corruption.⁸

The Cotonou agreement also stresses that cooperation must be exercised through a greater level of participation by the different actors and sectors of society. The new agreement highlights the importance of the non-governmental segments of society. Economic and social actors and the civil society are expected to be involved in the design, consultation and implementation of development strategies and programmes. In particular, the agreement underscores the importance of the private sector and the need to define criteria guiding the scope of participation of the different non-State actors.

Thirdly, as noted previously, the Cotonou agreement places strengthened emphasis on poverty eradication. The approach followed in the agreement is cognizant of the complex nature of poverty and proposes a comprehensive strategy for development. It stresses three priority areas of cooperation: economic development, social and human development, and regional integration and cooperation. The agreement also stresses that 'cooperation and priorities shall vary according to a partner's level of development, its needs performance and long-term development strategy.'

Finally, the reform of the trading arrangements represents the most radical change contained in the agreement with respect to the previous model of cooperation between the European Union and ACP countries.

To ensure full conformity with the WTO rules, EPAs will replace the current non-reciprocal trade arrangements. The new trading arrangements plan the progressive removal of

⁵ Cotonou Agreement, Article 1, p.7.

⁶ Cotonou Agreement, Article 8, p.13.

⁷ Cotonou Agreement, Article 8, p. 15

⁸ Cotonou Agreement, Article 9, p. 16.

barriers to trade and enhance cooperation in areas relevant to trade.⁹ They also provide the basis for the establishment of a free trade area with the EU. The trade negotiations started in 2002 and are still in process. The EPAs will enter into force in January 2008, but a transitional period of at least 12 years will provide for the progressive removal of trade barriers.

The Cotonou agreement recognizes the principle of differentiation as the levels of development and the different needs of the countries are also taken into account. Thus, the least-developed countries (LDC) will be able to continue receiving non-reciprocal trade preferences and from 2005 on, they will benefit from duty free access to the EU market for essentially all their products. The future trade cooperation also comprises other areas linked with trade such as competition policy, trade and labour standards.

More specifically Part 5 of the Cotonou Agreement also contains specific provisions for the Least Developed, Landlocked and Island States (LDLIC). Article 84 specifies that ACP-EU cooperation will ensure special treatment for these countries, taking into account their particular economic vulnerability. With respect to island States, which include the Caribbean, the Agreement provides for specific provisions and measures to be established to assist these countries in their efforts to overcome “the natural and geographic difficulties and other obstacles” to their development (Cotonou Agreement, Article 89).¹⁰

The objective of the type of trade cooperation emphasized in the agreement is to promote the gradual integration of the ACP States into the world economy.¹¹ To this end, the agreement puts great emphasis on the need to build a competitive private sector, enhance the capacity to attract foreign investment and improve the diversification of production. The agreement also highlights the strengthening of regional integration initiatives as a precondition for future trade cooperation.

The agreement argues that the move towards a free-trade area will bring benefits, such as the benefit of cheaper EU imports, but it also recognises that the ACP States may also have to face major challenges.

The EU applies very low or zero tariffs on most of its imports from ACP countries so that the effect of the removal of trade barriers on the external sector or for fiscal performance is bound to be modest. In other words the costs of trade liberalization for the EU are minor.

Contrarily ACP States will have to face the full force of global competition. As a result, they must use the preparatory period to modernize their economies and become more competitive. The transformation of their economies will require major adjustment costs in some cases. To address the challenges and constraints the ACP countries have to face, it is crucial to combine trade and economic policies with social development policies. From the point of view of the agreement, this should lead to economic growth and eventually poverty reduction.

The implementation of the new trading arrangements implies that the Lomé protocols need to be reviewed. The commodities exported under the protocols constitute in the cases of

⁹ Cotonou Agreement, Article 36, p.54.

¹⁰ Articles 2, 32,35,56,68, 84 and 89 contain provisions for Island States.

¹¹ Commission of the European Communities: Green Paper, p. xiii

some Caribbean countries the major exports to the European Union. As stated by the Council of the European Union, the Cotonou Agreement commits the ACP and the Community to review all the protocols in the context of the negotiations on EPAs.¹² In this regard article 36(4) of the agreement states:

“...the Parties reaffirm the importance of the commodity protocols...They agree on the need to review them in the context of the new trading arrangements, in particular as regards their compatibility with WTO rules, with a view to safeguarding the benefits derived there from, bearing in mind the special legal status of the Sugar Protocol.”

Finally the Cotonou agreement drastically reduces and simplifies the mechanisms of financial aid to ensure a greater degree of efficiency and flexibility.¹³ As stated in the agreement, the resources of the European Development Fund (EDF) will be channeled through two instruments: the Grant Facility and the Investment Facility. The Grant Facility will finance a wide range of long-term operations including macroeconomic support and sectoral policies. The dependency of stable export earnings in the agricultural and mining sector will also be taken into account and lead to granting supplementary resources within the Community Support Strategy. This system replaces the previous instruments, Stabex and Sysmin. The Investment Facility replaces the Lomé IV risk capital. It is meant to foster private sector development, providing risk capital and loans.

Furthermore the Cotonou Agreement introduces a system of “rolling programming”, which entrusts the ACP countries with enhanced responsibility. The allocation of resources is now based on the different needs and performances of the countries and will no longer be an automatic right. The allocation criteria take into account the partnership’s primary objectives, such as successful implementation of reforms and poverty reduction. The amount of development aid to the ACP States is always set for a five-year period reflecting the overriding goal for greater flexibility in the cooperation between ACP countries and the European Union.

¹² Council of the European Union. Annex to the Proposal for a Regulation of the European Parliament and of the Council establishing accompanying measures for Sugar Protocol countries affected by the reform of the EU sugar regime. 27 June 2005.

¹³ Commission of the European Communities: Green Paper, p. xiv

4. The protocols¹⁴

4.1 The sugar protocol¹⁵

4.1.1. The background

ACP countries became an integral part of the European sugar policy through the signature of the Sugar Protocol (28 February 1975). The Sugar Protocol has been attached to the Lomé Agreement and is now annexed to the Cotonou Agreement.¹⁶

The Protocol guarantees ACP countries access to the EU market for fixed quantities of sugar at preferential prices over an indefinite period of time. Thus, the signatory ACP States can import 1.3 million tonnes of white and raw sugar per year into the EU duty-free and at guaranteed prices.¹⁷ Article 5(4) of the Sugar Protocol states, that the guaranteed prices shall be negotiated annually. The Protocol is of indefinite duration ensuring its continuous application and independence relative to any agreement, to which it is annexed.¹⁸

The sugar protocol was designed to minimize the adverse effects and distortions resulting from the subsidies granted to European sugar producers under the CAP. Thus, through price stability and guaranteed market access the sugar protocol aims to ensure a fair income to former European colonies. The current price levels for European and ACP sugar producers are three times higher than world market prices.¹⁹ This encourages some of the ACP sugar countries to export as much of their production as possible to the EU.

In 1995, the EU introduced the agreement on Special Preferential Sugar (SPS). If European refineries cannot be supplied sufficient quantities via the Sugar Protocol, an additional duty-free import for raw cane sugar from the ACP countries and India can be demanded. This quota is usually around 150 000 tonnes.²⁰

¹⁴ Rice is another important commodity exported by CARICOM countries, mainly Guyana and Suriname. Although not subject to a protocol trade in rice is regulated by a tariff-quota regime. Guyana and Suriname share a quota.

¹⁵ The countries included in the sugar protocol are Barbados, Belize, Guyana, Jamaica, St. Kitts and Nevis, Trinidad and Tobago, Fiji, Congo, Ivory Coast, Kenya, Madagascar, Malawi, Mauritius, Mozambique, Swaziland, Tanzania, Zambia and Zimbabwe).

¹⁶ The European sugar policy dates back to 1968 and is part of the Common Agriculture Policy (CAP). The aims and principles of the CAP, including the sugar policy, are set out in Article 39 of the Treaty of Rome: (i) to increase agricultural productivity, (ii) to ensure a fair standard of living for the agricultural community, (iii) to stabilize markets, (iv) to assure availability of supplies, and (v) to ensure that supplies reach consumers at reasonable prices. These aims and principles are ensured to European sugar producers by support prices, production quotas to limit over-production and subsidies to export surplus production out of the European Union (EU). The EU sugar policy embraces both beet and cane sugar production.

¹⁷ European Commission, June 2005: The European Sugar Sector, 4. Sugar: EU and developing countries, p.1

¹⁸ World sugar production has more than doubled since the 1960s, but the EU's share in production, consumption and exports has decreased. The EU is still a major player on the world sugar market, but over the last ten years, Brazil and India have gained market share. The EU remains now far behind Brazil, the leading sugar exporter.

European Commission, June 2005: The European Sugar Sector, 3. European sugar in figures, p.4

¹⁹ European Commission, June 2005: The European Sugar Sector, 2. A sustainable future for the EU sugar regime, p. 1

²⁰ European Commission, June 2005: The European Sugar Sector, 4. Sugar: EU and developing countries, p.1

In 2001, the “Everything but Arms” (EBA) agreement was signed.²¹ It abolishes almost all tariffs for products imported into the EU from 50 LDCs, including six of the ACP sugar countries. The agreement states, that the abolition of tariffs is limited to a tariff quota of raw cane sugar for refining. The SPS quota for ACP countries is reduced by the amount to which the EBA sugar quota declines.

The current sugar regime ends on the 30 June 2006.²² Due to several reasons, a reform of the European sugar policy, including the Sugar Protocol, was thought to be unavoidable. For one thing, the EU imposes prices on sugar that are above those applied at the international level (see figure 1 below) the trend towards global trade liberalization has also encouraged the restructuring of the sugar regime. Thus, in 1995, the Uruguay round emphasized the WTOs commitment to reinforce the liberalization of agriculture markets.

Finally, another major reason for reforming is the case brought against the EU to the WTO Appellate Body by Australia, Thailand and Brazil in February 2004. The WTO ruled that the EU exceeded its export subsidy commitments since it exports up to 1.6 million tonnes of subsidized sugar annually equivalent to its preferential imports of ACP countries and India, without deducting them of its export subsidy limits.

4.1.2 The proposed reform of the sugar protocol

The EU proposed two packages (July 2004 and June 2005) for the reform of the sugar protocol.

The July (2004) reform package includes the following features: (i) a 33% reduction over three years in the preferential price that the EU pays to ACP sugar protocol countries for the purchase of up to 1.3 million tons of sugar per year; (ii) the reduction in price would start on 1 July 2005 with an initial price cut of 20% to be followed by further price cuts of 8% and 5%, respectively; (iii) the refiners’ margin which is currently paid by the EU would be transferred to ACP sugar producers; (iv) the EU would accompany the price cuts by specific measures, starting in 2007, destined to assist ACP sugar producers to diversify to other sectors of economic activity or improve their current level of competitiveness in the sugar sector; (v) the EU sugar producers will continue to receive direct income support of 60% through a decoupled payment.

ACP member States have voiced opposition to the reform package on the basis that the proposed price cuts are too large. More important ACP member States have argued that the reform package is contrary to the spirit of the ACP/EU sugar protocol which provided a guaranteed market and guaranteed prices. Finally, member States have noted that the reform package discriminates against sugar producers as it benefited beet producers. The ACP lobbying efforts have managed thus far to push back the date of implementation of the reform package and speed up the accompanying measures.

²¹ European Commission, June 2005: The European Sugar Sector, 4. Sugar: EU and developing countries, p.1

²² European Commission, June 2005: The European Sugar Sector, 2. A sustainable future for the EU sugar regime, p. 1

The June 2005 package proposal imposes further cuts on the price of sugar. The sugar price would decline by 39%. In addition the current proposal includes the following measures: (i) the EU regime will be prolonged until the end of the years 2014/2015 without a review of price and quota levels in 2008. The quota levels may change thereafter; (ii) the proposal does not contemplate any compulsory quota cuts; (iii) a restructuring scheme providing a high degressive per-tonne restructuring aid for factory closures and quota renunciation, plus a top-up payment to ensure sugar beet growers the possibility of receiving the full, final direct payment, in the event that they abandon production when the factory with which they have sugar beet delivery rights closes under the restructuring scheme.²³

More recently in November the EU has decided to move ahead with a 36% price reduction over the next four years beginning in 2006/2007. Among other measures, the EU also decided: (i) to compensate farmers at an average of 64.2% of the loss due to the price cut; (ii) that countries giving up at least 50% of their quota will receive a payment of 30% for the loss in income up to five years; (iii) the new regime will last until 2014/2015; (iv) the abolition of the current intervention price system and its replacement by a reference price; (v) to implement a voluntary restructuring scheme lasting four years for EU sugar factories; (vi) the creation of a diversification fund for EU member States where the quota is reduced by a minimum amount.

²³ The Commission of European Communities, Reforming the European Union's sugar policy. Update of impact assessment [SEC(2003) 1022]. Brussels, 22.6.2005. SEC(2005) 808.

Figure 1
Production costs for ACP countries
1980-2004 (averages)

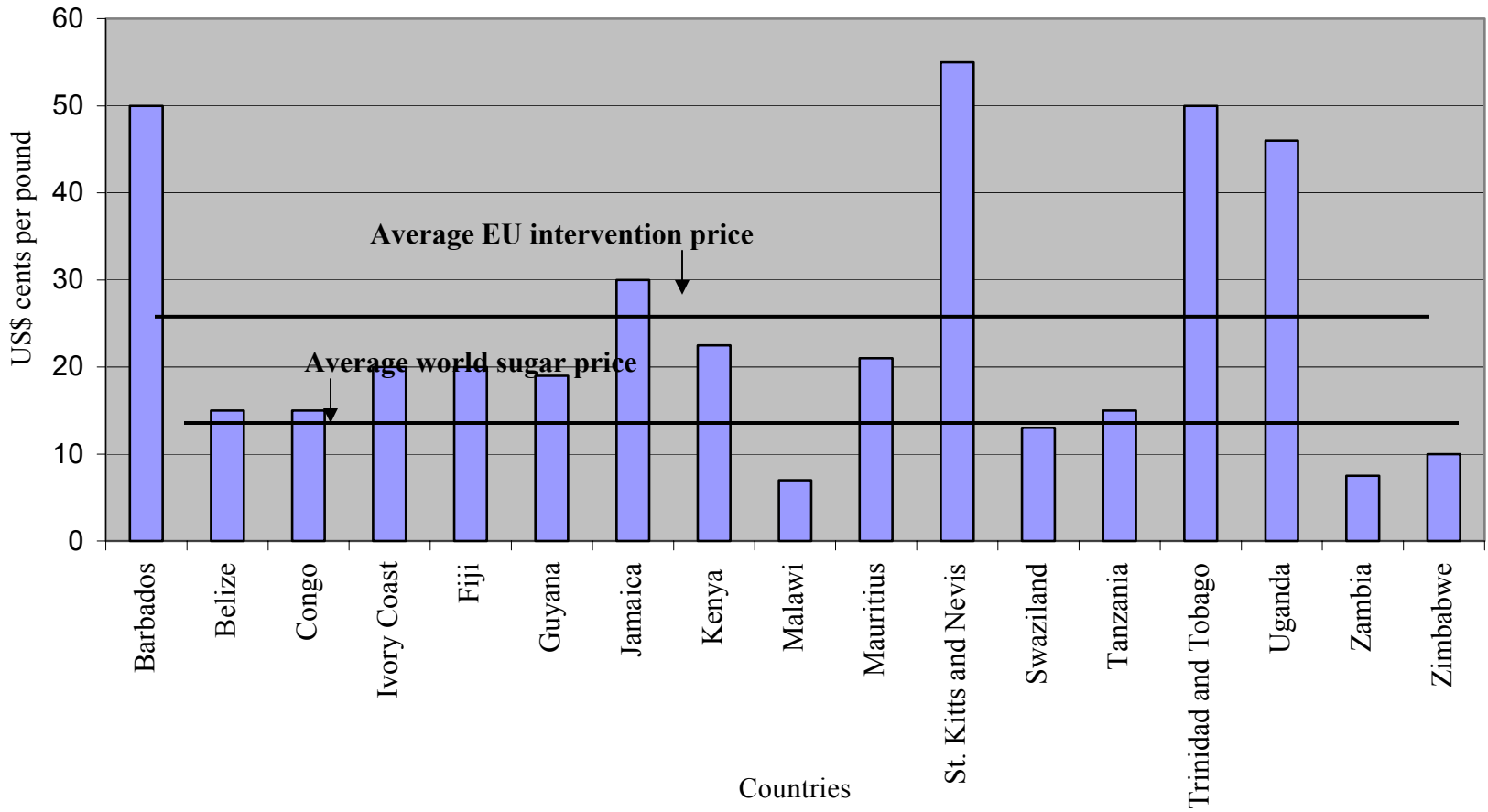
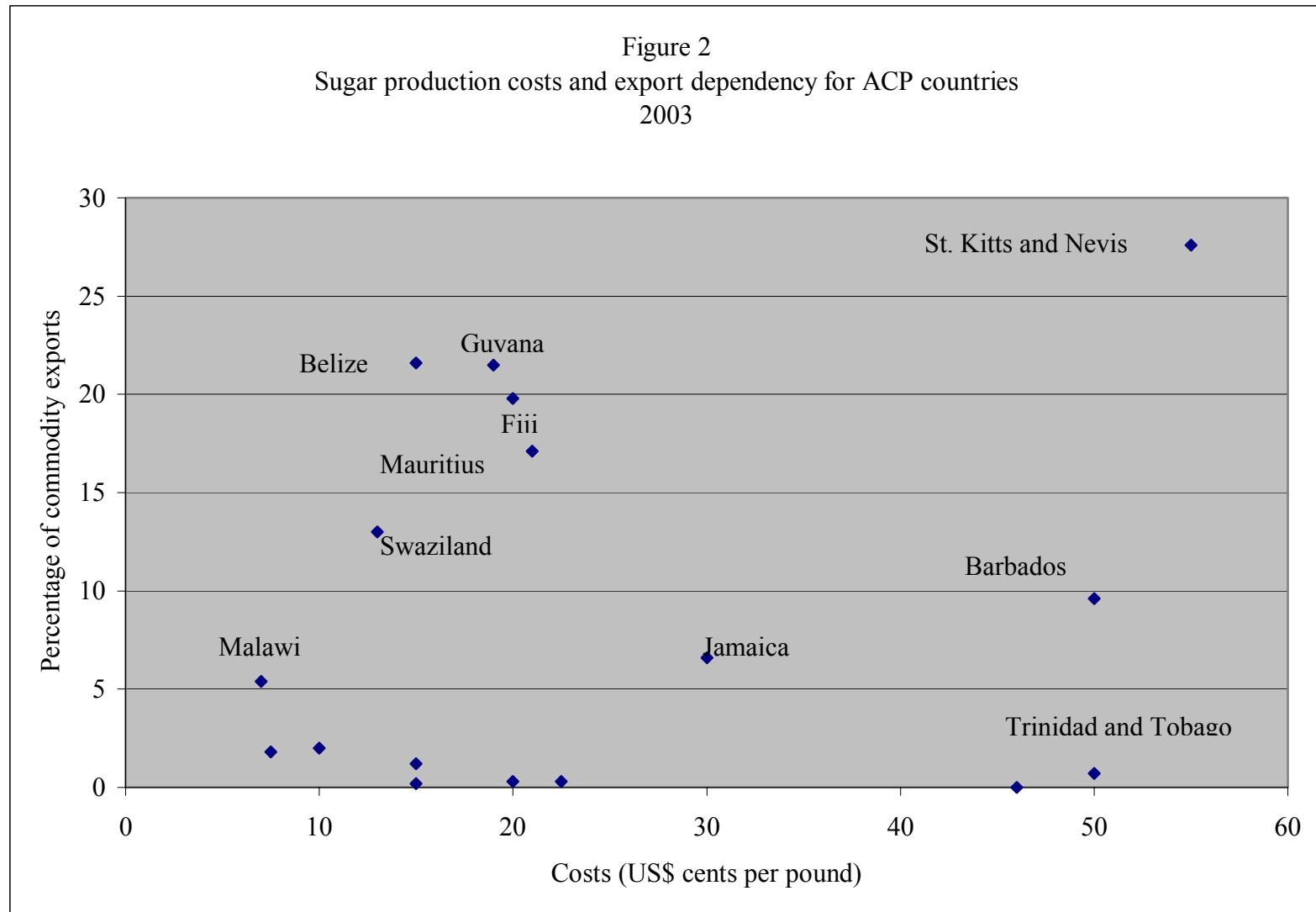


Figure 2
Sugar production costs and export dependency for ACP countries
2003



4.1.3 The dependency of the Caribbean on sugar exports to the EU

Currently 20 ACP countries export sugar under the Sugar Protocol.²⁴ With India the EU has an identical agreement, allowing it to export 10 000 tons of sugar per year. The main exporter of sugar to the European Union is Mauritius accounting for 25% of the market share. For some ACP States, sugar is an important contributor to economic growth. In some States, sugar exports under the Protocol amount to no less than 25% of GDP, and about 85% of total agricultural exports.²⁵

The Caribbean's major sugar producers, apart from Cuba which is not an ACP country, the Dominican Republic and Haiti which are not signatories to the ACP sugar protocol, are Jamaica, Trinidad and Tobago, St Kitts Nevis, Guyana, Barbados and Belize. Caribbean ACP protocol signatory countries represent 28% of the EU import market share. At the individual country level, Guyana, Jamaica, Trinidad, Belize and Barbados represent 11%, 8%, 3%, 3% and 2% of the EU import market share. According to Garside et al (2005) based on 2000-2002 figures, the European Union's market receives 84% of all sugar exports from Caribbean protocol signatory countries. The Caribbean receives 33% of all sugar quotas.²⁶

For the most part, Caribbean preferential sugar producers have production costs that exceed the international levels. Barbados, Jamaica, St. Kitts and Nevis and Trinidad and Tobago are amongst the highest cost producers (ranking 1st, 2nd, 3rd, and 5th among all ACP countries). In addition, Barbados, Jamaica, St. Kitts and Nevis, and Trinidad and Tobago exhibit the highest combination of dependency levels (measured by commodity exports as a percentage of the total) and production costs (cost of US\$ cents per pound) (See figures 1 and 2 below). Finally, Caribbean countries exhibit levels of productivity (measured by the ratio of volume of production to harvested area) and profitability (measured by the ratio of government revenue to production costs) which are below the average for ACP countries (See Table 1 below).

Among Caribbean sugar protocol countries, Guyana is the most important sugar producer, generating 14% of GDP, more than 10% of employment and 26% of its export earnings (See Table 1 below). Guyana also has the third largest EU sugar quota. Sugar is also important to Belize as it contributes 10% of GDP, 24% of export earnings and 13% of its labor force.²⁷

In the case of the rest of the countries sugar is not a fundamental contributor to GDP or employment. For Barbados, Belize, Jamaica and St. Kitts and Nevis, sugar represents at most 2% of GDP and less than 5% of the workforce. Nonetheless, sugar provides export earnings that are significant in the case of St. Kitts and Nevis and non-negligible in the case of Jamaica (56% and 7% of commodity exports). Nonetheless, the EU provides the largest and most lucrative market for sugar exports.²⁸

²⁴ European Commission, June 2005: The European Sugar Sector, 4. EU and developing countries, p. 1

²⁵ www.ACPsugar.org: Sugar Facts & Figures

²⁶ Sugar milling is mostly government owned. The exception is Belize where a foreign firm owns 10% of milling and workers own 90% of production. See, Garside et al. (2005), p.17.

²⁷ www.ACPsugar.org: Sugar Facts & Figures

²⁸ European Commission, May 2002: The Caribbean and the European Union, p. 30 and p. 38

Table 1
Caribbean sugar producers and exporters
Dependency on sugar
2003-2004

Countries	Contribution of sugar to GDP 2003-2004	Contribution of sugar to commodity exports earnings 1990-2004	Number of employees 2003	Contribution of sugar to employment 2003	Contribution of sugar to government revenue 2003-2004	Productivity 2003	Profitability 2003
Barbados	2.4	17.0	2,000-2,300	1.8	0.0	6.00	0.68
Belize	10	24.0	10,000-11,000	12.8	0.7	5.13	2.47
Guyana	13.6	26.1	22,000-24,000	>10.0	1.7	6.46	6.37
Jamaica	1.0	6.8	31,000-33,000	3.0	0.0	5.31	2.90
St. Kitts and Nevis	2.0	55.7	1,000-2,000	...	0.0	5.25	0.22
Trinidad and Tobago	0.5	0.5	24,000-26,000	>4.0	0.0	3.74	0.78
Average ACP	...	8.8	38,321	...	0.5	7.42	15.7

Note:

N.A. denotes not available.

Productivity is the ratio of production volume and harvested area. Profitability is the ratio of government revenue to production costs.

Source: On the basis of official data and TARIC (2005); European Commission Reports; Gaside et al. (2005) and LMC International (2005).

4.2 The banana protocol

4.2.1 The evolution of the banana regime

The primary purpose of the Banana Protocol under the first Lomé Convention was to safeguard the import of ACP bananas into the EU market. The establishment of the first banana regime in 1993 provided a definite content for the protocol.

The regime consisted of a system of tariff and tariff preferences (for ACP countries) and quotas. The principal aims of the banana regime were to harmonize the banana market, permit free movement of bananas within the EU and ensure adequate incomes for EU producers and for traditional ACP suppliers as well as guarantee fair prices for consumers.²⁹ The regime consisted of:

- (a) A quota of 2 million tonnes of bananas for Latin American countries (dollar bananas) and non-traditional ACP States;
- (b) A quota of 857,000 tonnes free of duty for imports from traditional ACP countries;
- (c) A license system which distinguished between operators marketing EU-produced and ACP-produced bananas (Category 'B' licenses) and operators in the EU marketing bananas from non-traditional ACP- and Latin American countries (Category 'A' licenses). Category 'C' licenses were established for new operators marketing non-traditional ACP bananas and dollar bananas; and
- (d) A within quota duty of € 100 per tonne for bananas from Latin America.

The regime was challenged several times by Latin American countries and the United States, which felt discriminated by the treatment granted to the traditional ACP banana suppliers. The banana regime was amended three times, leading to an erosion of ACP preferences.

In 1994, following a resolution of a dispute panel, the EU increased the quota for Latin American countries and non-traditional ACP countries to 2.1 million tones in 1994 and 2.2 million tones in 1995. Further, duties on these quotas were reduced to € 75 per tone. Following the EU enlargement, an additional quota of 353,000 for the dollar banana countries and non-traditional ACP countries was introduced.

In 1997, the banana regime was further revised. A new scheme, implemented in 1999, was based on a 2.353 million tones tariff quota for Latin American and non-traditional ACP countries. Moreover, it contained the removal of country-specific allocations under the traditional ACP quota, thus putting more importance on competitiveness. An additional change included the abolition of the operator categories established in the original regime, which

²⁹ National Economic Research Associates (www.nera.com): Nerareport, p. 16

removed the former incentive for importers to buy from traditional ACP States (see Boxes 5 and 6).

In April 2001, the EU finally reached a new resolution in discussion with the main critics of the banana regime. The resulting agreement consisted of a two-phased regime, which did not affect the duty free status of ACP countries. The first phase, operative for six months until the end of 2001, established three tariff-quotas to imports from all sources:

- (a) Quota 'A': 2.2 million tones at a tariff of € 75 per ton;
- (b) Quota 'B': 353 000 tones at a tariff of € 75 per ton; and
- (c) Quota 'C': 850 000 tones at a tariff of € 75 per ton.

The second stage was introduced in January 2002. It involved three major changes:

- (a) The 'B' Quota was increased by 100,000 tonnes with a corresponding decrease of the quota of the ACP countries (Quota 'C');
- (b) From 1 January 2004 onwards, the traditional operators' entitlement to license is based on usage of licenses issued under the new system; and
- (c) The tariff-quota and license system were expected to come to an end by January 2006 and replaced by a tariff-only regime consisting of the application of a bound duty of 230 Euros per metric tonne.

The decision to move to tariff only regime has not been satisfactory to the Most Favoured Nations (MFN) or ACP countries. For the EU the main issue is whether or not the tariff equivalent reduces the market access level provided to MFN countries. MFN countries have argued that the tariff only regime as currently proposed maintains the discrimination against Latin American banana producers. ACP countries on their part have highlighted the difficulty in determining the tariff equivalent of a tariff quota regime. Furthermore, they have argued that the 230 EU per metric ton seriously understates the level of protection provided under the tariff quota regime. Finally, they have noted that there is a margin between the highest level of tariff that the EU could have proposed and the actual level of tariff proposed while at the same time preserving market access for MFN countries.³⁰

³⁰ The rebinding of the concession for bananas at 230 Euros per metric tones was subject to an arbitration procedure "to determine whether the envisaged rebinding of the EC tariff on bananas would result in at least maintaining total market access for MFN banana suppliers." The arbitration procedure was "initiated pursuant to the procedures set out in the Annex to the waiver decision respect to Article I of the GATT (14 November 2001)." The negative answer of the arbitrator and the arbitrators concern over the "impact of the ACP supply response on the market access opportunities of MFN suppliers" led the European Union to revise its proposal and provide a an MFN tariff of 187 Euros per metric ton and a tariff quota for ACP countries of 775,000 metric tons per year at zero duty. See, WTO (2005) European Communities-The ACP-EC Partnership Agreement-Recourse to Arbitration Pursuant to the Decision of 14 November 14. WT/L/616. and WT/L/625.

4.2.2 Trends in banana exports

The largest banana importers are the United States with 30% of world banana imports, followed by the EU (26%) and Japan (8%).³¹ The majority of EU banana imports in the period 2000-2002 originated from Latin America (63%) and ACP countries (18%). Compared to the increase in demand for bananas in the world market, the rise of the total amount of EU banana imports has risen at a slow pace (2.7%) since the establishment of the regime in 1993. EU domestic imports and imports from Latin American banana countries increased slightly while the imports of ACP suppliers have remained stable.³²

Banana exports from ACP countries are destined entirely to the EU and the overall majority of Caribbean ACP bananas (from Belize, Jamaica, Suriname and the four Windward Islands of Dominica, Grenada, Saint Lucia and St Vincent and the Grenadines) are imported by the UK.

2003	Market share by country	Value in Euro	Share of Extra-EU	tonnes	Price/ kg in Euro*
Jamaica	4.10%	21,788,000	1.00%	41.784	0.52
Surinam	n.a	n.a	n.a	n.a	n.a
Belize	41.40%	37,010,000	1.80%	73.806	0.50
Saint Lucia	88.90%	20,980,000	1.00%	32.520	0.65
St. Vincent	9.00%	13,481,000	0.60%	20.919	0.64
Dominica	37.60%	6,865,000	0.30%	10.823	0.63
ACP countries	1.70%	486,422,000	23.10%	790.660	
2004					
Jamaica	1.80%	11,301,000	0.50%	28.660	0.39
Surinam	3.50%	6,001,000	0.20%	19.277	0.31
Belize	44.40%	35,164,000	1.40%	80.292	0.44
Saint Lucia	88.60%	27,909,000	1.10%	42.874	0.65
St. Vincent	6.30%	15,737,000	0.60%	23.969	0.65
Dominica	47.30%	8,135,000	0.30%	12.401	0.65

Nonetheless significant shifts within the ACP banana countries have taken place since the establishment of the banana regime. In 1993, the Caribbean ACP countries provided 374,000 tonnes of bananas- almost half the total of all ACP countries (748,000 tonnes). In 2002, they supplied only 185,000 tones (25%).³³ The difference is accounted for by the increase of the African ACP countries and the Dominican Republic.

³¹ Nerareport, p. 11

³² Nerareport, p. 12

³³ Nerareport, p. 12

Also since the adoption of the banana regime, all ACP countries have suffered an erosion of their preferences in favour of benefits for cheaper banana producer countries. The major reasons are the expansion of quota for Latin American and non-traditional ACP countries, the ending of the operator categories, which supported EU imports from traditional ACP countries and the movement from individual quotas for ACP countries to a global ACP quota. The Caribbean ACP countries can be considered to be the most banana-dependent of the ACP countries. Thus, they have been especially hard hit by the banana reforms, particularly the Windward Islands and Jamaica.

Statistics for all Caribbean ACP banana suppliers show, that over the last decade there has been a substantial fall of banana exports (in volume) and export revenues to the EU, and particularly to the United Kingdom market. Further, a sharp decrease in retail prices and a significant reduction of banana growers can be seen. Only imports of Belize have been fairly constant. Suriname had a substantial increase in exports until 2002, when its banana-export company went bankrupt and thus its exports sharply declined. For its part, the Dominican Republic witnessed a sharp increase in banana exports (See Table 3 below).

Jamaica and the Winward Islands have experienced a decrease of 50% and of 15%, respectively in their average banana exports before and after the implementation of the first banana regime. This has also had negative consequences on employment in the Windward Islands. The number of registered banana farmers dropped from 24,000 in 1993 to just over 7,000 in 2000 and production in the same period fell from 242,000 tonnes to 85,000 tonnes.³⁴ In 2002, the International Monetary Fund (IMF) reported, that “recent development in the international banana market has brought into question the viability of the Windward Island banana industry”.³⁵

The EU has applied three financial instruments to facilitate the restructuring of banana industries especially affected by preference erosion. A major source of assistance was the STABEX system – an income compensation to meet the loss of export earnings. Since 1995, considerable amounts of the STABEX allocations have been used for each of the Windward Islands.

This instrument is now replaced by the FLEX instrument of the Cotonou Agreement. In 1994, the EU established a Special System of Assistance (SSA), the objective of this system was to help banana suppliers to restructure to meet the challenge of improved access for non-ACP countries. The SSA was followed by a 10 -year Special Framework of Assistance (SFA) in 1999. This instrument aims to improve competitiveness by increased productivity and moreover, support diversification in the agricultural sector. The SFA provides income support like STABEX and additionally, technical assistance. All seven banana countries have been granted considerable amounts of the SFA.

³⁴ Nerareport, p. 40

³⁵ Nerareport, p. 42

Table 3
Banana export performance indicators
1990 - 2002

Year	United Kingdom import share by country provider					Production 000' tons	Number of banana growers 000'	Export volume 000' metric tons	Retail prices of bananas Pounds per Kg	Real prices 1990=100
	Jamaica	Suriname	Belize	Windward Islands	Other selected countries					
1990	13.40	5.96	5.11	52.13	7.45	282	n.a.	227	1.14	100
1991	14.31	5.73	3.89	41.10	10.43	230	n.a.	274	1.19	98.4
1992	13.76	5.50	5.14	40.00	13.39	280	n.a.	238	1.06	84.7
1993	11.76	4.27	5.80	23.97	9.01	242	24.1	169	0.96	75.4
1994	13.55	5.88	8.38	32.80	13.90	169	23	191	0.94	72.2
1995	13.66	4.55	6.67	31.22	13.33	194	20.2	191	0.8	59.4
1996	13.19	3.85	7.70	20.15	10.22	191	18	137	0.89	64.5
1997	11.96	4.50	6.52	21.12	18.63	137	16.3	141	1	70.2
1998	8.28	2.80	6.01	17.76	17.89	142	11.7	130	1.04	70.6
1999	7.12	4.52	6.30	19.86	22.74	131	12.6	140	1.02	68.2
2000	5.47	4.54	8.01	11.35	22.56	141	11.1	83	0.99	64.2
2001	5.83	3.93	6.37	13.55	33.20	85	7.3	99	1.08	68.9
2002	4.92	0.84	3.60	12.00	30.73	n.a.	n.a.	n.a.	1.02	64.1

Note: Other Countries include Colombia, Costa Rica and Honduras.
Source: On the basis of NERA (2003)

4.3 The rum protocol

The Rum protocol allowed the entry of ACP rum products duty free to the European Union. Under the Fourth ACP-EEC Convention signed at Lomé on 15 December 1989, only restricted amounts of both aged brown rums and bulk white rum were allowed to enter the European market. These restrictions were put in place because of concerns over competition for the rum producers in the French overseas departments (Martinique, Guadeloupe and Reunion).

Box 1
Lomé IV 1990-2000
PROTOCOL 6 on Rum

Article 1

Until the entry into force of a common organization of the market in spirits, products of subheadings 2208 40 10, 2208 40 90, 2208 90 11 and 2208 90 19 of the combined nomenclature originating in the ACP States shall be imported duty free into the Community under conditions such as to permit the development of traditional trade flows between the ACP States and the Community and between the Member States.

Article 2

(a) For the purposes of applying Article 167 and by the derogation from Article 168 (1) of the Convention, the Community shall each year, until 31 December 1995, fix the quantities which may be imported free of customs duties. These quantities shall be established as follows:

- until 31 December 1993, on the basis of the largest annual quantities imported from the ACP States into the Community in the last three years for which statistics are available, increased, in the period until 31 December 1992, by an annual growth rate of 37 % on the market of the United Kingdom and 27 % on the other markets of the Community.

However, the volume of the annual quantity shall in no case be less than 172 000 hectolitres of pure alcohol,

-for 1994 and 1995, the volume of the total quota shall in each case be equal to that of the previous year increased by 20 000 hectolitres of pure alcohol.

(b) For the arrangements applicable from 1996, the Community shall establish, before 1 February 1995, on the basis of a report that the Commission will send to the Council before 1 February 1994, the modalities for the projected abolition of the Community tariff quota, taking into account the situation and prospects on the Community rum market and of the ACP States' exports.

(c) Where the application of point (a) hampers the development of a traditional trade flow between the ACP States and the Community, the Community shall take appropriate measures to remedy the situation.

(d) To the extent that the consumption of rum increases significantly in the Community, the Community undertakes to carry out a new examination of the annual rate of increase fixed by this Protocol.

(e) The Community declares itself prepared to conduct appropriate consultations before determining the measures provided for in (c).

(f) The Community further declares itself willing to seek with the ACP States concerned measures to allow an expansion of their sales of rum on the Community market.

Source: ACP-EEC Convention of Lomé. Official Journal L 229, 17/08/1991

Official Journal L 025, 30/01/1976

In November 1996 the United States and the EU engaged in a round of trade discussions in Singapore which resulted in the EU agreeing to open its white spirits markets (such as gin and

vodka) to the United States, which in turn allowed better access to its technology markets. The consequence of this is that the MFN clause governing world trade required that any concessions had to be offered to all exporters. This was a blow to the Caribbean rum product from markets such as Brazil, Mexico, Panama and Venezuela, and estimates of losses to Caribbean producers stood at US\$260 million per annum.

However, this in effect then abolished the quantitative restrictions imposed upon the Caribbean exporters and also reduced the dependency upon the European markets. The 2000 Cotonou agreement was the formal end to the Rum Protocol under the Loma agreement as it recognized “the importance of the rum sector for the economic and social development of several ACP countries and regions and its major contribution in providing employment, export earnings and Government revenues.” It further established rum as “a value added agro-industrial ACP product ... [and] shall be imported ... duty free and without quantitative restrictions.”

More than this, the Agreement makes provisions for fair competition and that ACP rum products would not be disadvantaged or discriminated and offers grants financed by the EDF under ‘windows’ that are designed for modernization and upgrading of facilities, marketing and distribution, waste treatment and business plans.³⁶

Barbados, Bahamas, Guyana, Jamaica, and Trinidad and Tobago are the main exporters of rum to the European Union. As a percentage of total external sales, rum exports have gained importance for the Bahamas, Barbados Contrary in the cases of Jamaica and Trinidad and Tobago, exports of rum have lost importance as a percentage of total exports (see Table 4 below).

Table 4				
Selected CARICOM country exports to Western Europe as a percentage of total exports 1985-2002				
	1985	1990	1995	2002
Bahamas	10.6	7.3	15.6	35.9
Barbados	1.6	2.8	3.6	9.2
Jamaica	6.0	5.0	2.8	2.5
Trinidad and Tobago	5.3	21.6	22.5	1.0
Guyana	3.0	3.4	3.1	3.1
Source: CAN (2005)				

³⁶ ECDPM. 2001. Cotonou Infokit: From Lomé to Cotonou (13). Maastricht: ECDPM. The Courier ACP-EU. “Adding punch to the Caribbean Rum Industry.” No 198, May-June 2003. http://europa.eu.int/comm/development/body/publications/courier/index_198_en.htm

5. The negotiations between CARIFORUM and Europe³⁷

5.1 The current status of the negotiations

With the Cotonou Agreement, ACP countries agreed to turn their non-reciprocal trading arrangement into fully reciprocal regional integration areas in the form of EPAs. ACP countries launched negotiations for EPAs in September 2002. The Caribbean region and the EC started the EPA negotiations in April 2004.

The EPAs timetable includes four phases (See Table 5 below). Phase 1 of the negotiations which was completed in September 2004 established the objectives of the EPAs. The EPAs are instruments whose objective is to: (i) facilitate the sustainable development and structural transformation of Caribbean economies; and to (ii) strengthen the regional integration process with CARIFORUM (RNM, 2005).

In accordance, the EPA negotiations are based on four principles. First, the EPAs “support and are built upon the regional integration process.” Second, EPAs should promote and be consistent with development objectives and priorities. Third, the EPAs should include special and differential treatment provisions to address the constraints to growth and development imposed on CARIFORUM countries by their small size. Finally, the EPAs should improve market access possibilities for CARIFORUM exports.³⁸

Phases	Timetable	Objectives
First phase	April 2004-September 2004	Establish the concerns and interests of EPA negotiations
Second phase	September 2004-September 2005	Establish the regional integration priorities to be supported and key areas of assistance prior to the entry in force of the EPAs.
Third phase	September 2005-December 2006	Establish an agreement on the approach to trade liberalization.
Fourth phase	January 2007-December 2007	Resolution on remaining areas of disagreement and definition of institutional framework for the implementation of EPAs.

Source: Humphrey (2005)

³⁷ The EU and CARIFORUM are the negotiating partners. The Regional Negotiating Machinery (RNM) negotiates on behalf of CARIFORUM at technical and senior-officials level and prepares ministerial meetings. CARIFORUM refers to the 15 countries involved in the negotiations (CARICOM countries and the Dominican Republic).

³⁸ Humphrey, E.L. EPAs: State of Play with the CARIFORUM-EC Negotiations. A briefing to the Committee on International Trade of the European Parliament (13 September, 2005).

According to the RNM one of the main differences between Europe and CARIFORUM in this phase of the negotiation resided in the extent of the product coverage subject to trade liberalization in future agreements. The EC maintained that the threshold should be set at 90% of the traded products. Caribbean negotiators argued that the extent of product coverage subject to trade liberalization should be in correspondence with the level of development of the negotiating parties. The Caribbean's current level of economic development does not warrant a product coverage threshold subject to free trade, which is equal to 90% of the total.

Phase II of the negotiations were completed in September 2005. They had two objectives:“(i) the definition of the economic space assuming commitments under an EPA; (ii) the identification of the regional priorities of CARIFORUM and secure support by Europe to assist with their implementation” (Ibid).

Phase II was termed a “qualified success.” It accomplished the identification of the respective economic spaces that will assume commitments under EPAs. During Phase II the priority areas to be supported by an EPA were also identified. However, tangible support by the European Union to assist with their implementation has not been secured.

Phase III will delineate the biregional market access commitments of both parts. More precisely the objectives are threefold: “i) to establish an agreement on the structure of EPA; ii) to consolidate the outcome of the discussion on the priority issues for CARIFORUM regional integration; iii) to define the approach to trade liberalization to be adopted in the negotiations.”³⁹

The Phase III negotiations, which will focus on four areas, market access, services and investment, trade-related issues, and legal and institutional issues, will begin *de facto* after the WTO Hong Kong ministerial (December 2005). The Hong Kong Ministerial meeting is bound to provide guidance on developmental issues, such as special and differential treatment, which are fundamental to the EPA negotiating process.

5.2. The differences in vision underlying the EPA negotiations

While both CARICOM and the European Union are in agreement with the basic principles of the Cotonou agreement there are differences between the EU and CARICOM'S approach to the EPAs.

According to the former, the Cotonou agreement must rigorously comply with the requirements of article XXIV of the WTO.⁴⁰ As such, Europe views the EPAs as a tool to promote the development of its signatory members guided by the principles of reciprocity and

³⁹ CRNM. News Release. September 28, 2005.

⁴⁰Article XXIV authorizes customs unions and free trade zones as an exception to the principle of non-discrimination. The regional agreements and free trade zones are expected to remove barriers to trade with respect to the essential of the trade which originated in the constituting members of the customs union or free trade areas. Finally, Article XXIV seems concerned with avoiding the trade deviation effect of free trade areas or customs unions and explicitly states that in order to avoid trade deviation, tariff and/or other trade measures should be established at a level, which in their aggregate, does not make these more restrictive than those previously imposed by the individual members. In addition, Article XXIV also states that country members may maintain trade restriction among members of a trade agreement on the basis of GATT's articles XI, XII, XIII, XV and XX.

free trade. Free trade should improve ACP market access possibilities, stimulate investment and promote economic growth.

Contrarily, CARIFORUM understands trade liberalization as a necessary but not sufficient condition for economic development. Trade liberalization must be applied and suited to the particular conditions of signatory member States. In the case of CARICOM the reduction in tariffs may translate into significant revenue losses thus hardening the fiscal constraint of governments. The erosion of preferential access is also bound to affect key products such as sugar and bananas that are a significant source of employment and livelihoods for some member States. CARIFORUM understands that the EPAs must be accompanied by asymmetric provisions and must be linked to development assistance.

From the point of view of CARIFORUM these asymmetric provisions should mirror those adopted within the WTO framework. In the WTO texts (1994) the concept of special and differential treatment is embodied in a set of provisions allowing developing countries greater flexibility in terms of obligations and time frames to overcome these so called ‘adjustment costs.’ These provisions are grouped under four headings. These are (i) those recognizing the interests of the least developed and developing countries; (ii) the measures that reduce or ease the rules and obligations that developing economies have to meet; (iii) the provisions providing for longer time-frames for the implementation of obligations; and (iv) the provisions for technical assistance (WTO, 1999c, p.225).⁴¹ (See also Box 2 below).

Box 2
A proposal for special and differential for smaller economies
<p>On the basis of WTO texts Richard Bernal grouped appropriate provisions specific to smaller economies can be grouped under seven headings:</p> <ol style="list-style-type: none"> 1. A Lower Level Of Obligations Smaller economies would be required to undertake commitments and concessions to the extent consistent with their adjustment capacity, development, financial and trade needs, and their administrative and institutional capabilities for implementation. This should be negotiated on an issue-by-issue basis and where appropriate, and product-by-product basis. 2. Asymmetrically Phased Implementation Timetables Given the smaller size of firms in smaller economies and the smaller scale of production and limited size of the market, export sectors will require a longer period of adjustment than larger firms and larger, more developed economies. Hence, there must be asymmetrically phased implementation of rules and disciplines, permitting a longer adjustment period for smaller economies. For example, in agricultural trade, in particular, food items, smaller economies should be allowed the flexibility to implement their commitments to reduction of protection and domestic support over a longer period than the implementation period prescribed for larger economies. 3. Best Endeavor Commitments Both larger and smaller economies should commit to best endeavors in implementation of S&D treatment. (a) Larger economies should, wherever possible, provide measures and accept timetables, which provide consideration to smaller economies. For example, careful regard should be given by developed countries to the peculiar situation of smaller economies when considering the imposition of antidumping duties. Larger, more developed economies should be required to explore the possibility of constructive remedies (i.e. price undertakings) before imposing duties where these would affect the essential interests of smaller economies. (b) Where flexibility is provided there should be some criteria to assess the extent to which smaller economies are making adequate efforts, for example, when smaller economies have achieved “export competitiveness” in a given product they would be expected to phase out concessions over an extended period.

⁴¹ See, WTO. Special and Differential Treatment. Synopsis of WTO Agreements and Related Topics. MM/LIB/SYN4. 23 October 2000 for a detailed list of the provisions of the WTO Agreements on Special and Differential Treatment.

4. Exemptions From Commitments In Certain Areas

Given the vast disparities in size, the extremely smaller size of some economies and the human, financial and institutional cost involved in implementing new trade agreements such as the FTAA, smaller economies should be permitted some exemptions. This would not only address the question of disparities, but also avoid delays, which may occur because smaller economies, despite their best effort, were not able to meet certain requirements and timetables. For example, if, as is likely, exports subsidies are outlawed, smaller economies should be exempt from this requirement, or standardizing technical requirements through national organizations and participation in international standardization processes where these have no applicability because of lack of production or importation or exports. Where complete exemptions are not feasible, the minimis provisions would be helpful.

5. Flexibility In Application And Adherence Of Disciplines Under Prescribed Circumstances

Smaller economies are highly open economies and are therefore more susceptible to balance of payments problems. This is particularly the case for smaller developing countries where balance of payment deficits tends to be persistent because of their structural origins. For example, the FTAA process might consider balance of payment provisions such as those provided in Articles XII and XIII of the GATT. It should be noted that these provisions are not confined to any particular type of country but all members may avail themselves of the right resort to these provision under the circumstances prescribed. Smaller economies because of their vulnerability to balance of payment problems should be permitted additional facilities to enable them to (a) maintain sufficient flexibility in their tariff structure to be able to grant the tariff protection required for the establishment of a particular industry, and (b) apply quantitative restrictions for balance of payments purposes which take full account of the continued high level of demand for imports likely to be generated by their programs of economic development.

6. Enabling Access To Mediation

The Understanding on Rules and Procedures governing the Settlement of Disputes is currently under review in light of the experiences of the past few years. The problems, which have been identified with, the operations of the dispute settlement mechanism include: (a) the limited capability of smaller countries to make use of the mechanism because of their inadequate expertise and institutional capacity to implement panel findings. (b) The high cost and administrative difficulties of using the dispute settlement mechanism.

7. Technical Assistance And Training

The promise of technical assistance to the smaller economies is now widely accepted. Such assistance could: -

- (a) contribute to efforts by smaller economies to undertake the structural, institutional and legislative adjustment
- (b) promote the development of adequate institutional capacity including training to improve their handling of negotiations, and implementation of the international trade agreements
- (c) assist smaller economies in fulfilling their obligations under the various international agreements, in particularly commitments under the WTO

No trade agreement and no set of relevant and meaningful special and differential measures should be expected to rectify structural and market weaknesses at the national level. A special and differential framework such as that described is unlikely to generate welfare gains for smaller economies unless it is accompanied by internal policies aiming at reducing their vulnerability.

Source: Bernal, Richard L. "Smaller Economies in the WTO" Unpublished paper, 2001.

In addition CARIFORUM's approach follows the principle of variable geometry, in view of the three streams of regional integration processes in existence within the region, which include the Organisation of Eastern Caribbean States (OECS), the CARICOM Single Market and Economy (CSME) and the CARICOM-Dominican Republic free trade agreement. These three different trade agreements have different levels of integration. The OECS is a currency union, the CSME is an incomplete customs union, and the CARICOM-Dominican Republic is a free trade agreement in the making. Their coexistence has led CARIFORUM to ask for differentiation in the negotiations among its member states.

Finally, CARIFORUM has also stressed that the development and execution of EU-funded projects should precede the EPA agreements. Thus far, potential projects or areas for European Union funded projects have been identified in sanitary and phytosanitary measures, agriculture, competition policy, standards, trade facilitation and regional integration.

6. Issues for non-independent Caribbean countries, territories and regions

Like the ACP countries that opted for independence in the second half of the twentieth century, which in Cotonou agreed to redefine the framework for their trade and cooperation relationship with the European Union, the countries and territories that continued, in one form or another, to depend politically on a European country, are involved in a process of redefinitions. These processes are necessarily intertwined because they are in a general sense affected by the global liberalization trend and the Doha round of WTO trade talks and, in a more direct way, they are both immersed in the evolution of the European Union's integration and common foreign trade and development assistance policies and institutions. The possibility of non-independent countries to participate in the EPAs is still under discussion but will be rather limited.

The processes are also closely linked because in the Caribbean region, ACP countries and their non-independent neighbors have many political, economic, social and cultural ties, arising from shared history and sometimes language, borders and institutions. They are, in one word, close. The type of relation of one group of countries to the European Union is bound to affect the other. This chapter assesses the stakes of non-independent countries in the Caribbean region's EPAs.

The Caribbean countries, territories and regions that are somehow part of a member State of the EU, have many different political, legal and economic arrangements in place. The EU has recognized two categories.

6.1. The outermost regions

In the Caribbean, three French departments are recognized as outermost regions. They are Guadeloupe, French Guyana and Martinique.

Second, several sector policies should be highlighted. Regarding the Union's sugar policy, the Commission sent the Council and Parliament in 2003 a communication in which it proposed to give the outermost regions a different treatment in the reform of the instruments, the precise contents of which remain to be specified. In the case of bananas, since 1993 the outermost regions benefited from compensatory aid for marketing, giving banana production a notable boost. Rice production in French Guyana, affected by the Community's reduction of the intervention price but benefiting from income support of 177 Euros per ton, nevertheless receives special consideration because the "decoupling" measure, which cuts the link between support and production, will not be compulsory in this region. French Guyana also benefited from a scheme to compensate for additional costs entailed by isolation from the European market for the disposal of fisheries products. To finalize this illustrative sample of a long list of sector support programmes, the transport sector may be mentioned. The Commission has adopted a favorable approach to aid for the purchase or replacement of aircraft in the outermost regions, providing tax relief for investment in Air Caraïbes for the purchase of new aircraft. In short, many if not all the European Union's sector programmes have special clauses for outermost regions. Some have a direct bearing on what is being negotiated in the Caribbean EPAs.

A third area of policies of particular interest in the context of the present paper refers to regional integration. Through the Interregional Community Initiative, strands B (transnational cooperation) and C (interregional cooperation), funds are available to promote integration of outermost areas into the regional geo-economic area. The Caribbean Interreg III programme (2000-2006) of Euro 24 million supports economic and social integration of the DOMs in the Caribbean area. The regional programme for the Caribbean of the European Development Fund, managed by CARIFORUM, finances joint measures between Departements d'outre-mer (DOMs) and Caribbean ACP countries.

This synopsis of European policies regarding its outermost regions, in this case the French Caribbean DOMs, underscores the notion that the negotiations of an EPAs between CARIFORUM and the European Union need to address the issue of CARIFORUM-DOM relations. There may be contentious issues, and the European Union has hinted at these by indicating that it will take into account the specific interests of the outermost regions. CARIFORUM countries may have reasonable arguments to request a special treatment to compensate for remoteness and insularity, similar to the benefits in place for DOMs, for example. If not, special support measures for DOMs maybe taken as obstacles in leveling the playing field for competition in certain industries. Sometimes these issues take a different spin, such as in the case of the proposed changes to the sugar protocol. The specific interests of outermost regions seem to align with those of the ACP countries in the sense that both groups support each other and requested special access to the European market to be preserved. The marginal position that both groups of countries have in each other's economies should make it relatively easy to resolve the more contentious issues. In any case, a deepening of economic relations and more functional collaboration in areas such as international migration, protection of the environment, technical cooperation and the like should have positive impacts that by far outweigh possible negative consequences for particular industries in specific countries and regions.

6.2. Overseas countries and territories

Some countries or territories in the Caribbean depend constitutionally on a member State of the European Union, with varying degrees of autonomy. However, they are not part of the European Union and Community law does not apply to them. For seven of these, the relation to the European Union is set out in an association regime, contained in articles 182 to 188 of the European Community Treaty. Five are Overseas Territories (OT) of the United Kingdom (Anguilla, British Virgin Islands, Cayman Islands, Montserrat and Turks and Caicos Islands)⁴². The remaining two Caribbean Overseas Countries and Territories (OCTs) are autonomous countries within the Kingdom of the Netherlands, namely Aruba and the Netherlands Antilles. The latter country is a federation of five islands, each with a degree of island autonomy and differentiated policies.⁴³

⁴² One OT of the United Kingdom, Bermuda, requested not to be included in the Association Treaty with the EC.

⁴³ The seven countries or territories taken together have a total population of close to 400,000 inhabitants, about 1.5 times the population of Barbados, and the size of the combined economies is roughly comparable to the nominal GDP of Jamaica. The population of this OCT group is about 40% of the total population in Caribbean Outermost Regions, and its combined nominal GDP is about half. The economies of the Caribbean OCTs are based on tourism, ranging from mass cruise-ship and beach

In order to assess the issues related to the CARIFORUM-EU Economic Partnership Agreements and the OCTs it is necessary to take into account that OCTs may have different macroeconomic settings, trade regimes and production structures. Furthermore, in each OCT the process of redefining its relationship with the European Union has specific characteristics.

The Netherlands Antilles, the most populated and sizeable economy of the seven, provides undoubtedly the most complex situation.⁴⁴

The country is currently in intense negotiations with the Government of the Netherlands about alternative political and constitutional arrangements. Referendums have been held and far-reaching proposals are on the table, the main one entailing a break-up of the five island federation. The populations of Curacao and St. Maarten have expressed their preference to obtain, separately, a Status Aparte similar to Aruba, while the other three islands would prefer a direct constitutional dependence with the Netherlands. The redefinition of their relations with the European Union is part of the considerations.

Ideally the five islands of the Netherlands Antilles need to be considered separately in any attempt to assess the implications of a CARIFORUM-EU EPAs on this OCTs, and the issues related to the Netherlands Antilles that should be considered in the EPA negotiations. Sint Maarten, as a tourist-oriented free zone, should be most interested in the parts of the agreement that deal with liberalization of trade in services, which is strongly linked to the General Agreement on Trade in Services (GATS) negotiations, and European support to improve tourism infrastructure in their neighboring islands⁴⁵. It is evident, however, that strengthening tourism services in the surrounding islands would not necessarily affect in a negative way the economy of St. Maarten. The tourism “product” of these islands should be understood as one, based on a common “Caribbean” brand name. In fact, collaboration between the islands is already strong through the Caribbean Tourism Organization (CTO) of which all independent Caribbean countries (except Dominican Republic), OCTs, outermost regions (except French Guyana), even Puerto Rico and United States Virgin Islands, as well as the islands of the Netherlands Antilles, separately, (except Saba), are members. If a Caribbean EPAs strengthens tourism infrastructure and services in CARIFORUM countries, its benefits would undoubtedly have positive spill-over effects on the entire region.

The situation is more complex for islands such as Curacao and Aruba. Aside from the tourism linkages, for which the argument, by and large, would follow the same line as indicated

tourism to elite marine-based tourism, together with off-shore business services and, in the case of Aruba and the Netherlands Antilles, oil-refinery and free-zone services.

⁴⁴The country as it is today, a federation of five islands, autonomous within the Kingdom of the Netherlands, was created in 1986 when Aruba left the federation and acquired its “Status Aparte” within the Kingdom. Of the five islands, Curacao and Bonaire are close to Venezuela and St. Maarten, St. Eustatius and Saba are hundreds of miles to the Northeast, in the vicinity of Anguilla and St. Kitts and Nevis. Their political union was never easy and the country’s economy never became fully one. Curacao shares with Aruba a common language, Papiamentu, whereas in the North-eastern islands English is the language of choice. St. Maarten, in the north, is a free-trade zone while Curacao, in the South, maintains high import tariffs. A company that produces in St. Maarten and sells in Curacao will have to pay customs duties as well as high transport costs. Intra-island trade within the Netherlands Antilles is therefore only 2% of the federation’s external trade. Antilliaanse Economie, Economenblad, Vol. 27, June 2004

⁴⁵ PriceWaterhouseCoopers, Sustainability Impact Assessment (SIA) of the EU-ACP Economic Partnership Agreements, especially the section Caribbean Region: Tourism, provides an encompassing overview of the possible impacts of a Caribbean EPA on the tourism sector.

for Sint Maarten, both islands have an important oil-refinery industry and some local production of light manufacturing. Curacao is also a trade hub for distribution of products, mainly of Asian origin, and related services throughout the Caribbean region and the nearby countries in South America. The Caribbean EPA negotiations as well as the policy evolution regarding Outermost Regions and OCTs may alter the relative benefits of different special relationships with the European Union. In the trade sphere, products from Europe would be able to enter the CARIFORUM economies against reduced tariffs and trade in services would be further liberalized, but products and services from Aruba and Curacao would not benefit from this. The Caribbean market is critical for these countries, especially for the Curacao distribution hub.

Also for other OCTs, the implications of a Caribbean EPA and the OCT-related issues that should be addressed in the EPA negotiations cannot easily be generalized and have specificities in each one of the countries and territories considered.

The British Virgin Islands, an economy that thrives on off-shore business services and luxury tourism, has the specificity of its geographic vicinity with the United States Virgin Islands and Puerto Rico. The local currency is the United States dollar and imports originate mainly from the United States. The country's merchandise exports are negligible. The country's obvious interests in the Caribbean EPAs would refer to liberalization and strengthening of tourism services, together with eventual consequences for off-shore business services.

The Turks and Caicos Islands have recently reached an agreement with the United Kingdom about constitutional reform. Self-government will be strengthened while the United Kingdom's essential interests are preserved. The economy has been growing strongly on the basis of demand for vacation homes by United States tourists. Its predominant economic orientation is toward the United States and the country's involvement in regional affairs is limited. The country has few merchandise exports and imports come predominantly from the United States. Although the effects of a Caribbean EPAs on the economy would appear to be very limited, and the country has limited relations with CARIFORUM, the Government of Turks and Caicos Islands has expressed the wish to become involved in the EPA negotiations. Functional cooperation with Caribbean neighbors, especially in the areas of transport, tourism and environmental management should be of considerable interest.

In any case, in the words of the President of the Association of Overseas Countries and Territories,⁴⁶ the overseas countries and territories are affected by their more indeterminate relationship with the EU and by greater economic and trading uncertainty. Cotonou defines a comprehensive trade and development cooperation relationship for ACP countries with the European Community and the policy toward Outermost Regions is becoming a full-fledged development strategy in the context of the cohesion programme, including an area of functional cooperation between the two groups of countries in certain regions. On the other hand, a comprehensive European approach toward OCTs is much less clear, complicated by disparities in circumstances and interests. In general, these countries should be adversely affected by the erosion of trade advantages, their "inability to connect into the world trade system"⁴⁷ and their

⁴⁶ Speech by Mr. C. Stanbrook at the EPA Seminar for EU Outermost Regions and Overseas Countries and Territories, Brussel, 13-15 June 2005

⁴⁷ *ibid*

vulnerabilities stemming from isolation, remoteness and size. They will have to make a strategic decision whether to strive for the status of outermost region, with its loss of political independence and its gains in preferences; or to strive for fuller independence including, possibly, the status of EPA beneficiary; or, maintain the in-between status of OCT and work out a special arrangement with the best possible trade and economic cooperation relations with the European Community, either individually or collectively. None of these options will be easy or swift. Caribbean integration would benefit from an analysis that encompasses all types of countries and regions, and all types of possible arrangements.

The possible degree of involvement of OCTs in the EPA process is still under discussion. The European Commission cannot conclude an EPAs with an OCT because they are not sovereign States. OCTs cannot participate, not even observe, EPAs negotiations because only the Commission negotiates on behalf of the Community and not even EU member States can observe the negotiations. The only possible ways of OCT involvement in the EPAs discussions would be through closer collaboration with either the United Kingdom or the Netherlands and, through them, with the Commission or, on the other hand, through closer collaboration with CARIFORUM. These options neatly define the strategic juncture where OCTs find themselves.

7. Trade trends between Europe and the CARICOM

7.1 Trade flows in goods between CARICOM and the European Union

CARICOM's trade is mainly directed to the United States and Europe. Available data from 1991 to 2004 show that, at the aggregate level, both destinations represent on average a quarter of its total merchandise exports respectively. The data shows an increase in the share of CARICOM exports to the United States and a decline in its exports to the European Union. (see Table 6 below).

At the country level the share of exports destined to Europe varies considerably. It is lowest for the Bahamas and Trinidad and Tobago (8% and 9% on average for 1991-2004). It is highest for the OECS accounting for 32% of total exports for the same period. Dominica and St. Vincent and the Grenadines have the highest percentage of their exports destined to the European Union (42%).

The breakdown of total CARICOM exports to the European Union by country share for 2001-2004 indicate that, Guyana, Trinidad and Tobago, and Jamaica have the most significant shares (40%, 25% and 20%, respectively). Contrarily Belize, Barbados, and the OECS have the smallest shares (3%,2% and 1%).

At the product level, CARICOM's export composition to Europe has not significantly varied over time. The available data shows that the set of products, which accounted for 86% of total exports to Europe represented 92% of the total in 2002. This is reflected in the low value of the structural change index which was computed on a rolling basis at 0.23 for the main export products of CARICOM to the European Union.

In addition the composition is highly concentrated. At three digit level, three products account for half of CARICOM's imports to the European Union (ores and concentrates, ships and boats, sugar and honey (19%, 18% and 11% of the total for 2002, respectively). Similarly, 10 products account for 80% of CARICOM's exports to Europe. Export concentration is captured by the Herfindahl-Hirschmann index which takes a value greater than 0.5 in most cases.

A greater level of disaggregation shows an even higher concentration of CARICOM exports to Europe. Data at the six digit level shows that seven products account for 80% of the exports of CARICOM to Europe. In a similar vein one product methanol/alcohol represents close to 50% of all CARICOM exports to the EU (see Table 8 below).

Table 6				
Exports to the European Union and NAFTA as a percentage of total exports				
Total exports to the European Union as a percentage of total exports				
	1991-1995	1996-2000	2001-2004	Average
OECS	33.84	32.43	29.57	31.95
Antigua and Barbuda		23.31		23.31
Dominica	43.16	41.96	40.03	41.71
Grenada	22.94	27.28	25.57	25.26
St. Kitts and Nevis	28.20	19.03	7.35	18.19
Saint Lucia	34.33	38.95	33.31	35.53
St. Vincent and the Grenadines	40.60	44.06	41.59	42.08
LDCs	27.28	27.68	23.45	26.14
Belize	20.71	22.93	17.33	20.32
MDCs	19.31	16.39	16.03	16.63
Bahamas, The		7.28	9.12	8.20
Barbados	24.18	24.50	23.42	24.03
Guyana		18.99	19.81	19.40
Jamaica	17.36	17.57	18.17	17.70
Suriname	23.41	20.49	19.14	21.01
Trinidad and Tobago	12.28	9.54	6.54	9.45
CARICOM	26.72	24.30	21.78	23.55
Total exports to NAFTA as a percentage of total exports				
OECS	16.04	17.29	20.21	17.85
Antigua and Barbuda		26.31		26.31
Dominica	6.76	7.97	9.74	8.15
Grenada	27.03	22.70	24.10	24.61
St. Kitts and Nevis	21.70	30.22	42.52	31.48
Saint Lucia	15.46	10.77	16.28	14.17
St. Vincent and the Grenadines	9.22	5.78	8.40	7.80
LDCs	23.70	22.37	25.01	23.69
Belize	31.36	27.45	29.81	29.54
MDCs	26.16	31.04	30.65	30.37
Bahamas, The		42.56	40.75	41.66
Barbados	25.05	24.96	25.67	25.23
Guyana		30.42	29.80	30.11
Jamaica	29.07	29.27	28.06	28.80
Suriname	13.54	18.17	16.26	15.99
Trinidad and Tobago	37.00	40.86	43.37	40.41
CARICOM	21.62	24.42	26.23	24.94
Source: WITS (2005)				

Table 7				
Imports from the European Union and NAFTA as a percentage of total imports				
Total imports from the European Union as a percentage of total imports				
	1991-1995	1996-2000	2001-2004	Average
OECS	14.18	10.88	10.95	11.44
Antigua and Barbuda		7.49		7.49
Dominica	16.36	12.22	12.14	13.57
Grenada	13.42	10.71	10.53	11.55
St. Kitts and Nevis	8.54	6.74	6.88	7.39
Saint Lucia	14.88	13.08	12.12	13.36
St. Vincent and the Grenadines	17.72	15.04	13.06	15.27
LDCs	11.15	9.10	8.48	9.69
Belize	8.11	7.31	6.01	7.15
MDCs	13.41	10.47	11.61	11.17
Bahamas, The		1.81	1.17	1.49
Barbados	12.18	11.17	12.38	11.91
Guyana	15.44	10.64	10.97	12.35
Jamaica	7.02	7.00	7.86	7.29
Suriname	17.34	21.19	21.99	20.17
Trinidad and Tobago	15.07	11.00	15.27	13.78
CARICOM	12.28	9.78	10.04	10.43
Total imports to NAFTA as a percentage of total imports				
OECS	32.42	35.18	35.87	34.87
Antigua and Barbuda		37.57		37.57
Dominica	29.64	33.18	33.77	32.20
Grenada	32.96	35.18	35.92	34.69
St. Kitts and Nevis	38.03	40.27	41.12	39.81
Saint Lucia	31.16	33.02	34.83	33.00
St. Vincent and the Grenadines	30.31	31.87	33.72	31.97
LDCs	38.21	39.81	22.81	39.51
Belize	43.99	44.44	45.61	44.68
MDCs	32.91	36.05	34.64	35.37
Bahamas, The		47.69	48.07	47.88
Barbados	33.08	33.80	33.71	33.53
Guyana	31.29	35.43	34.23	33.65
Jamaica	39.44	38.99	38.24	38.89
Suriname	31.06	24.68	22.82	26.19
Trinidad and Tobago	29.67	35.73	30.77	32.06
CARICOM	35.56	37.93	28.72	37.44
Source: WITS (2005)				

The classification by economic category shows that CARICOM exports mainly consumer and intermediate goods (34% and 36% on average for 1995-2002) of the total and to a lesser extent raw materials and capital goods (16% and 12% for the same time period). The classification by economic aggregate indicates that agricultural materials and food are the main export products (60% of the total for 1995-2004 on average for the same time period) followed by ores and metals and manufactures (14% and 13%, respectively, for 1995-2004 on average).

Products	Share of CARICOM exports to the European Union	Accumulated Share
Methyl alcohol /methanol/	46.64	46.64
Wire rod iron steel not high carbon	10.83	57.47
Sponge iron or steel	7.77	65.23
Ammonia, anhydrous or in aqueous sol	6.22	71.45
Nutmeg, mace & cardamons	3.82	75.27
Excavating, levelling, boring, etc.	2.37	77.64
Special purpose vessels (e.g. light v	1.79	79.43
Amine-function compounds	1.60	81.03
Other miscellaneous food preparation	1.47	82.51
Source: WITS (2005)		

Country	Number of commodities exported	Diversification index	Concentration index
Barbados	184	0.739	0.45
Dominica	135	0.482	0.637
Jamaica	190	0.452	0.502
Saint Lucia	155	0.826	0.557
St. Kitts and Nevis	141	0.766	0.624
St. Vincent and the Grenadines	145	0.700	0.60
Trinidad and Tobago	205	0.470	0.203

Note: The diversification index refers to the absolute deviation of the country share from the world structure. It is equal to: $D_i = \sum (S_{ij} - S_i)/2$, where S_{ij} = share of commodity i in total exports of country j. S_i = share of commodity i in total world exports. The diversification index takes higher values as the export structure is less diversified. The concentration index is the Herfindahl-Hirschmann index. The index ranges from 0 to 1. A value of 1 is an indication of maximum concentration. It is equal to: $(\sqrt{\sum (x_i/X)^2} - \sqrt{1/n}) / (1 - \sqrt{1/n})$

x_i = value of exports of product i.
 X = total exports.
 n = number of commodities.
 Source: WITS (2005)

At the country level in the majority of cases the main export products are primary products. In the cases of Barbados, Belize Dominica, Grenada, Guyana, St. Kitts and Nevis, and Saint Lucia, agricultural products are the main export products (29%, 39%, 74%, 76% and 88% of the total). For Jamaica, Suriname, and Trinidad and Tobago, mining products are the main export products (61%, 75% and 71% of the total, respectively). Antigua and Barbuda, The Bahamas and St. Vincent and the Grenadines constitute the exception as their most important export product is ships and boats (92%, 40% and 76% of the total).

By far the majority of the products exported by CARICOM to the EU enter duty free (see Table 8 below). Note that some of the main products exported (rice, sugar, fruits and nuts) fall under the provisions of the Lomé Protocols.

CARICOM imports from the EU are less significant than its exports. The EU imports represent 11% of the total for 1991-2004. The North American Free Trade Area (NAFTA) is the main supplier of CARICOM (37% of the total for the same period). The most dependent countries on European imports include Suriname, St. Vincent and the Grenadines, Trinidad and Tobago and Saint Lucia (20%, 15%, 14% and 13% of their total exports on average for 1991-2004). (see Table 7)

The composition of imports differs in the degree of its value added content from that of exports. Exports include mainly commodities which are labour intensive and with low technological content. Contrarily imports comprise mostly products with medium technological content. More precisely, imports include mainly manufactures followed by machinery and transport equipment, agricultural materials and food products (33%, 11%, 8% and 8%, respectively, on average of the total for 1996-2003).

With the exception of manufacturing the major categories of imports are not the most protected products. Indeed the correlation coefficient between the main import categories as a percentage of the total and the corresponding weighted tariff rates is equal to 0.22. As visual inspection well of the scatter plot does not show a positive relations between both variables (see Figure 3 below). This follows from the fact that, contrary to other integration arrangements, CARICOM's tariffication is inversely related to the value-added content of imported products. That is the most protected product are those with low value added, that is agricultural products.

Figure 3
Relationship between average weighted tariffs and imports
1996-2003

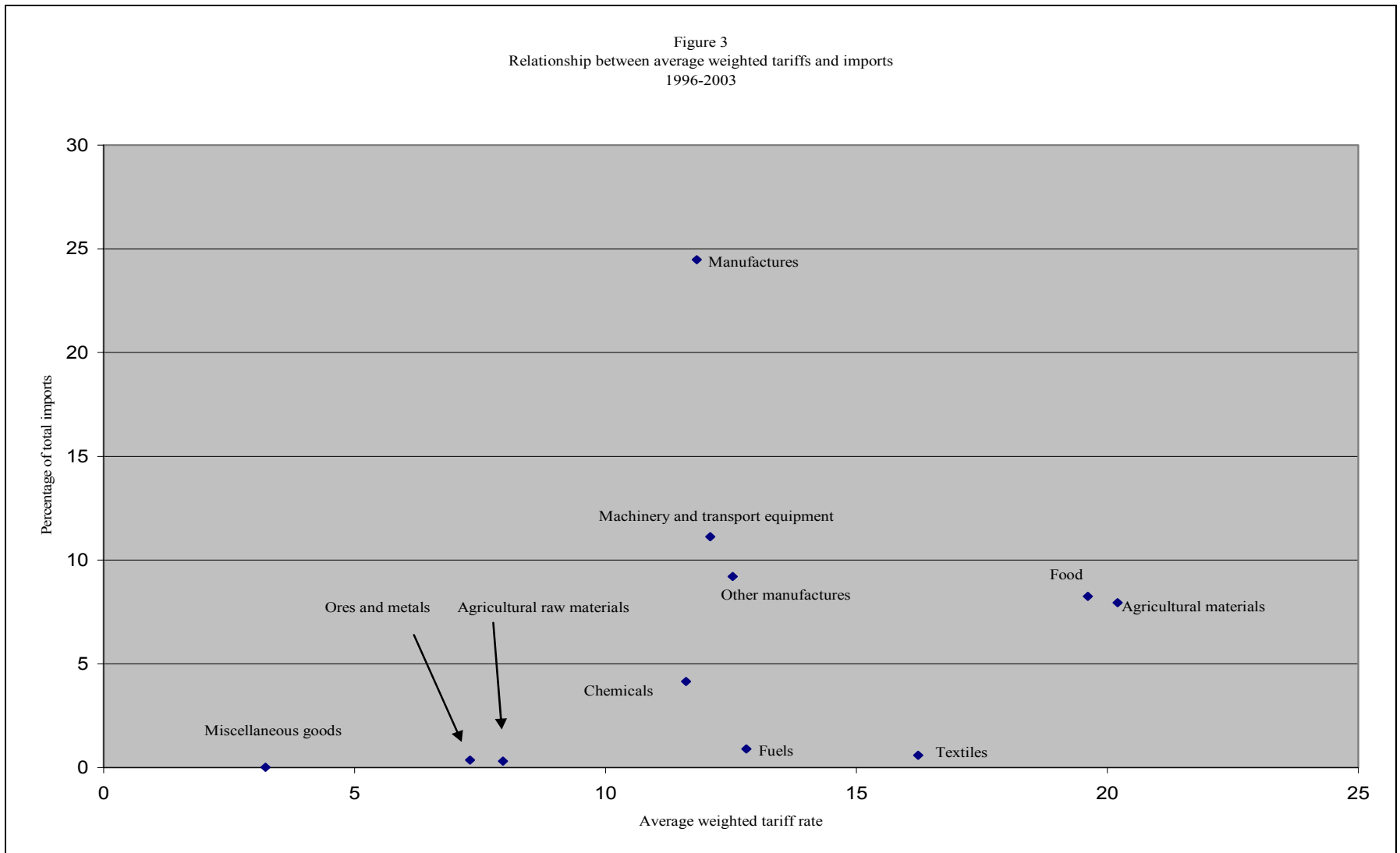


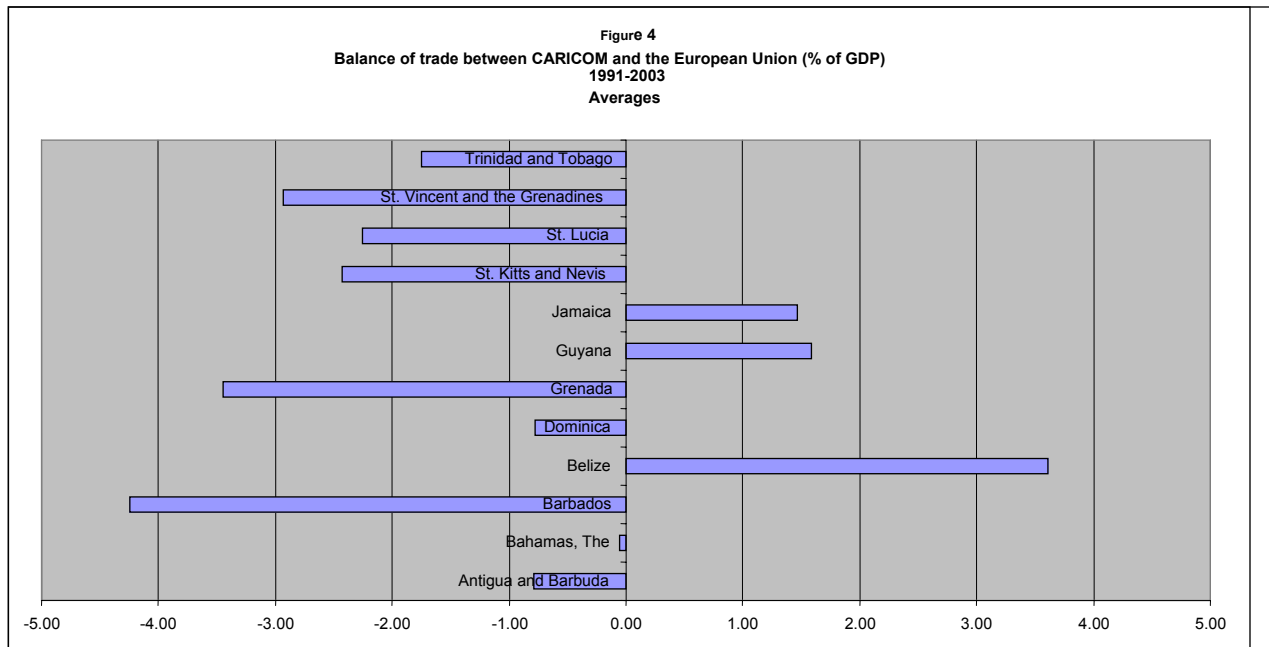
Table 10
Imports of CARICOM from the European Union by aggregate
Share of total (averages)
1996-2003

Product name	Antigua and Barbuda	Barbados	Bahamas	Belize	Dominica	Grenada	Guyana	Jamaica	St. Kitts and Nevis	Saint Lucia	St. Vincent and the Grenadines	Trinidad and Tobago	Average
Agricultural Materials	9.83	5.44	6.14	14.47	9.84	8.59	7.85	4.86	8.89	10.10	8.91	4.10	8.25
Agricultural Raw Materials	0.10	0.28	0.07	0.12	0.19	0.15	0.07	0.08	0.54	0.72	1.30	0.14	0.31
Chemicals	2.01	5.66	8.05	3.60	6.12	2.45	5.01	5.24	2.33	2.61	3.22	3.55	4.15
Food	9.73	5.17	6.07	14.35	9.65	8.43	7.78	4.78	8.35	9.38	7.61	3.96	7.94
Fuels	0.22	0.05	6.06	0.07	0.03	0.07	0.31	1.32	0.06	0.08	0.02	2.45	0.89
Machinery & Transport Equipment	13.80	10.88	7.61	6.60	8.57	13.18	10.52	14.76	9.51	11.11	9.09	17.80	11.12
Manufactures	23.07	27.54	24.75	18.70	23.30	24.49	25.17	27.78	24.16	22.80	23.80	28.21	24.48
Miscellaneous Goods		0.00	0.02			0.01		0.00		0.00		0.00	0.01
Ores & Metals	0.15	0.24	0.04	0.11	0.14	0.18	0.13	0.42	0.59	0.68	1.37	0.23	0.36
Other manufactures	7.26	11.00	9.09	8.50	8.61	8.86	9.64	7.78	12.33	9.08	11.49	6.87	9.21
Textiles	0.97	0.76	1.21	0.31	0.41	0.51	0.52	0.33	0.39	0.54	0.72	0.39	0.59
Total non-oil trade	32.90	32.98	30.90	33.17	33.14	33.08	33.01	32.64	33.05	32.90	32.71	32.31	32.73
Source: WITS (2005)													

Table 11
Weighted tariff rates of European imports by aggregate
2003

Product name	Antigua and Barbuda	Barbados	Bahamas	Belize	Dominica	Grenada	Guyana	Jamaica	St. Kitts and Nevis	Saint Lucia	St. Vincent and the Grenadines	Trinidad and Tobago
Agricultural Materials	15.78	34.06	13.26	16.61	14.34	53.3	16.93	19.29	11.36	15.71	10.26	14.43
Agricultural Raw Materials	4.91	9.04	27.69	6.54	4.75	22.87	7.64	1.73	0.35	1.7	6.91	1.38
Chemicals	10.75	13.41	14.61	8.71	5.84	38.85	8.61	6.1	7.45	10.52	7.96	6.43
Food	15.9	35.09	13.09	16.62	14.53	56	17.07	19.48	12.45	16.85	10.42	14.95
Fuels	7.31	5	34.26	28.53	5.38	24.27	10.77	5.75	9.82	1.3	7.7	13.6
Machinery & Transport Equipment	12.29	10.79	37.58	7.65	8.89	25.17	6.8	5.27	9.32	7.3	11.63	2.37
manufactures	11.7	12.2	24.55	8.06	10.49	29.75	7.53	5.89	8.96	8.67	10.64	3.39
Miscellaneous Goods			0			5						4.67
Ores & Metals	3.51	5.95	31.13	7.74	4.32	18.59	7.96	0.52	0.24	0.79	4.76	2.12
Other manufactures	10.59	13.36	21.43	8.03	16.74	30.85	7.84	7.32	8.9	10.3	10.46	4.6
Textiles	15.47	13.6	25.93	11.87	14.49	43.76	5.54	9.53	18.74	17.13	13.57	5.15
Total non-oil trade	12.87	15.52	21.69	11.16	11.66	35.44	9.51	7.71	9.4	10.47	10.52	4.49
Source: WITS (2005)												

CARICOM economies have registered in the aggregate for most years for which data is available (1991-2004) a trade deficit with the European Union. This follows from the fact that as implicitly stated above, CARICOM's imports from the EU have an income elasticity of demand that exceeds that of its exports. The deficit averaged US\$160 million and reached US\$443 million in 2003. Trinidad and Tobago, Barbados, and the OECS explain most of the accumulated deficit for the said period. Some of the most dependent economies on trade with Europe have exhibited for most years a positive trade balance with Europe. The trade imbalance represents -1% of GDP for CARICOM in the aggregate and +2% of GDP for deficit and surplus countries alike. Belize and Barbados register the largest surplus and deficit respectively (3.6% and -4.2% of GDP) (see Figure 4 below).

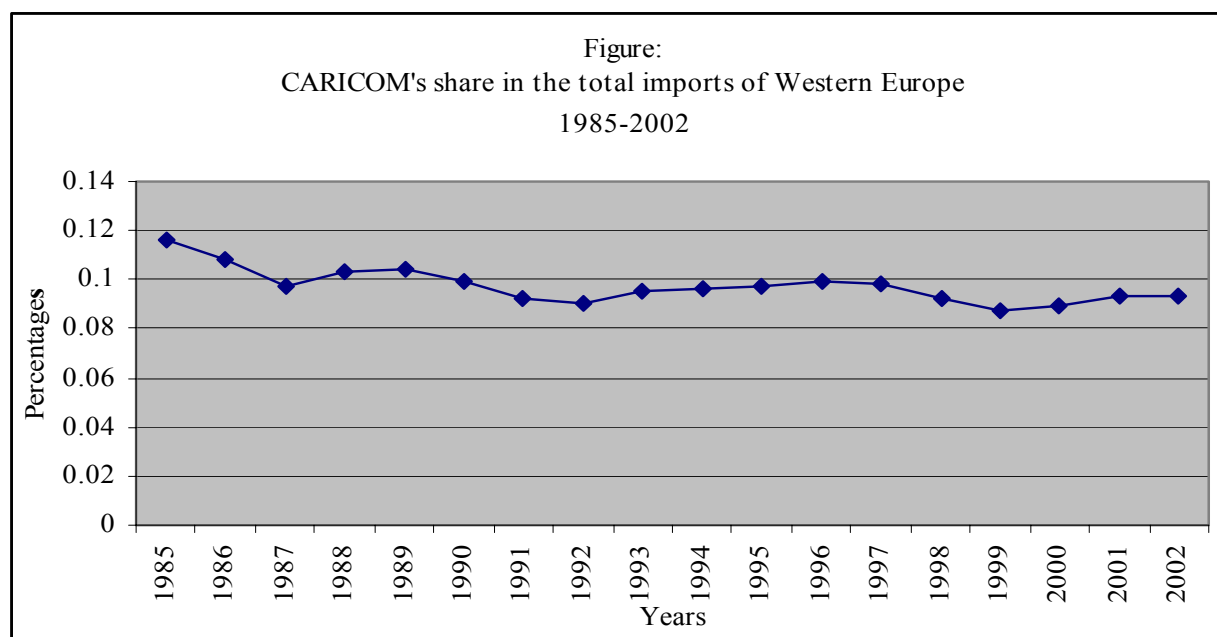


Product/Country	Export share	Market share		Import share		Market access
	2002	1985	2002	1985	2002	
Ships and boats						
Antigua and Barbuda	91.7	0.247	2.200	0.508	0.379	NR
The Bahamas	39.6	0.284	2.242	0.508	0.379	NR
St. Vincent and the Grenadines	75.81	0.011	0.932	0.508	0.379	NR
Fruit and Nuts						
Belize	39.14	0.074	0.17	0.905	0.688	NR
Dominica	32.6	0.364	0.074	0.905	0.688	NR
Jamaica				0.905	0.688	NR
St. Lucia	88.35	0.834	0.176	0.905	0.688	NR
St. Vincent and the Grenadines	19.83	0.346	0.134	0.905	0.688	NR
Suriname		0.233	0.069	0.905	0.688	NR
Spices						
Grenada	68.2	1.401	1.628	0.043	0.033	NR
Cocoa						
Grenada	6.6	0.139	0.037	0.347	0.137	NR
Fresh fish						
Grenada	5.5	0	0.01	0.425	0.406	NR
Suriname	1.42	0.003	0.04	0.425	0.406	NR
Sugar and Honey						
Barbados	28.75	1.053	0.489	0.245	0.189	NR
Belize	35.22	0.955	0.556	0.245	0.189	NR
Guyana	49.89	3.434	2.157	0.245	0.189	NR
Jamaica	10.72	2.509	1.599	0.245	0.189	NR
St. Kitts and Nevis	76.1	0.293	0.233	0.245	0.189	NR
Trinidad and Tobago	6.19	0.946	0.566	0.245	0.189	NR
Alcoholic beverages						
The Bahamas	35.9	0.405	1.203	0.554	0.641	NR
Barbados	9.2	0.01	0.046	0.554	0.641	NR
Fruit preserved and fruit preparations						
Belize	6.06	0.005	0.061	0.329	0.296	NR

Rice						
Guyana	14.86	0.483	2.747	0.084	0.044	NR
Suriname	4.29	5.588	1.118	0.084	0.044	NR
Ores and concentrates						
Suriname	75.76	2.465	3.392	0.571	0.257	NR
Jamaica	61.31	1.767	6.715	0.571	0.257	NR
Electrical machinery						
Dominica	14.5	0	0.017	1.511	1.376	NR
Pig Iron						
Dominica	8.7	0	0.088	0.24	0.154	NR
Rotating plants						
St. Kitts and Nevis	10.14	0	0.014	0.33	0.405	NR
Note: NR = no restrictions						
Source: CAN (2004) and TARIC (2005)						

7.2 A competitive analysis of CARICOM exports to Western Europe

At the aggregate level, CARICOM has lost market share over time. This is clearly seen in Figure 4 below. CARICOM's market share in Western Europe's imports declined from 0.12% to 0.09% between 1985 and 2002. At the country level, Guyana, Saint Lucia and Trinidad and Tobago register the largest drops in market share. The European Union has also lost market share in the CARICOM import market. In 1985 and 2003, the European Union represented 19% and 15% respectively of all CARICOM imports.



In order to gauge the competitiveness of CARICOM exports to CARICOM a competitiveness matrix was constructed. The computations were carried out using ECLAC's CAN software programme. (see Table 13 below).⁴⁸

⁴⁸ The analysis combines the change of an exporter country's product market share with the dynamism of product demand. Exporter countries can either gain or lose market shares in specific products. Products can have either stagnant or dynamic import demand. Rising Stars refer to a situation in which a country gains market share in a product with dynamic demand. Declining Stars indicate market share gains where demand is less dynamic or stagnant. Missed opportunities are situations where losses in market share occur together with dynamic demand. Finally, Retreats are those situation in which an exporter country loses market share in conditions of stagnant demand.,

Table 13					
CARICOM exports to Western Europe					
Market share competitive matrix, 1985-1990, 1990-1995 and 1995-2002					
at the three digit level and expressed as a percentage of the final year exports					
Stagnant commodities			Dynamic commodities		
		First period	58.0	First period	41.6
		Second period	45.6	Second period	54.1
		Third period	64.9	Third period	34.9
Market share gains		Declining stars		Rising stars	
First period	68.2	First period	34.5	First period	33.7
Second period	84.2	Second period	43.7	Second period	40.5
Third period	57.7	Third period	45.0	Third period	12.7
Market share losses		Retreats		Missed opportunities	
First period	31.4	First period	23.5	First period	7.9
Second period	15.5	Second period	1.9	Second period	13.6
Third period	42.1	Third period	19.9	Third period	22.2
Source: CAN (2004)					

Table 14					
European Union exports to CARICOM					
Market share competitive matrix, 1985-1990, 1990-1995 and 1995-2002					
at the three digit level and expressed as a percentage of the final year exports					
Stagnant commodities			Dynamic commodities		
		First period	62.7	First period	32.9
		Second period	84.6	Second period	33.7
		Third period	41.3	Third period	58.2
Market share gains		Declining stars		Rising stars	
First period	30.9	First period	22.3	First period	68.6
Second period	45.4	Second period	30.7	Second period	14.7
Third period	55.2	Third period	13.1	Third period	42.1
Market share losses		Retreats		Missed opportunities	
First period	64.7	First period	40.4	First period	24.3
Second period	72.9	Second period	53.9	Second period	19.0
Third period	44.9	Third period	28.2	Third period	16.7
Source: CAN (2004)					

In the first period (1985-1990) CARICOM benefited from favorable demand conditions mainly in stagnant markets. CARICOM registered market share gains for most exports (68% of the total). The majority of the market share gains (58%) occurred in stagnant markets and 42% of the total occurred in dynamic markets.

In the second period (1990-1995) CARICOM increased its market share gains for the greater majority of its exports to Western Europe. Market share gains occurred mainly in dynamic markets (54% of the total).

In the third period (1995-2002) CARICOM member States witnessed deterioration in their competitive position in the European market. Although most of Caribbean exports (57.7%) were still able to register market share gains, the percentage is lower than in the previous periods. In addition, stagnant commodities explained a higher percentage of Caribbean exports than in any previous period.

Overall a comparison between CARICOM exports to the EU and those of the EU to CARICOM shows that, CARICOM has, over time, experienced market share losses and that these losses are concentrated in stagnant commodities. For its part, between 1985 and 2002 the European Union has gained market share in dynamic commodities (See Tables 13 and 14 above).

A more detailed analysis of the data at the products level reveals that the majority of CARICOM export products have lost market share in the EU. In addition CARICOM has lost market share in most of its main primary products, namely sugar and honey, rice and fruits and nuts, and cocoa. Finally, CARICOM has gained market share in mining and manufactured products (ores and concentrate, electrical machinery, ships and boats, among others).

7.3. Trade flows in services between CARICOM and the European Union

The services sector has traditionally been identified as the sector that will provide the impetus for growth in the future and thus should continue to contribute to output, growth, employment and the provision of basic needs. Services form a major portion of CARICOM economies and, in particular, of those of the OECS domestic economies. Services also represent the bulk of CARICOM and OECS foreign exchange earnings. In the case of the OECS, services represent between 65% and 90%% of total exports of goods and services.

The available empirical evidence shows that, as expected and reiterated, Mode 2 is the main form of CARICOM provision of services. For the OECS, Mode 1 has increased its share over the total provision of services over time and represented 20% of the total in 2001. As a result, the gap between both has narrowed over time. Contrarily the More Developed Countries (MDCs) have witnessed an opposite trend with Mode 2 increasing as a percentage of the total (i.e., Mode 1 falling as a percentage of the total). Overall for the last period for which data is available (1995-2000) Mode 1 and 2 represent on average roughly the same share of export services for both OECS and MDCs (See Tables 15 and 16 below).⁴⁹

⁴⁹ The state of existing data allows the classification of services exports only for GATS Modes 1 and 2. Mode 1, which is defined as ‘the supply of a service from the territory of one member into the territory of any other member’ is measured as the sum of the commercial services in the disaggregated balance of payments data minus travel. Mode 2, which is defined by GATS as ‘the supply of a service in the territory of a member to the service consumer of any other member,’ is measured as the sum of travel found in the balance of payment statistics. Mode 3 (defined as ‘the supply of a service by a service supplier of one member through commercial presence in the territory of any other member’) is proxied by FATS accounts and Mode 4 (defined as ‘the supply of a service by a service supplier of a member, through presence of natural persons of a member in the territory of any other member’) by the balance of payments line, compensation of employees. Data to provide estimates for Modes 3 and 4 is not available.

Table 15						
Exports of services Decomposition by category						
In percentage of the total 1985 -2002						
	1980-1985	1985-1990	1990-1995	1995-2000	1992-1995	1995-2002
OECS						
Percentage contribution of services subcategories to the total						
Transport	0.44	9.40	10.94	9.31	8.57	8.67
Travel	88.91	79.20	77.12	73.83	74.6	66.6
Communications	....	1.64	1.27	....	...	...
Construction	....	....	0.12	0.08	0.00	0.09
Computer and information services	....	....	....	....	0.00	0.09
Insurance	....	1.01	1.20	2.01	1.93	2.03
Financial services	....	....	....	1.78	0.00	2.28
Royalties and license fees	....	....	0.12	....	0.00	0.02
Other business services	10.49	7.70	9.17	11.92	13.40	18.36
Personal, cultural and recreational services	....	....	....	....	...	...
Government services n.i.e.		1.71	1.02	1.44	0.21	1.18
MDCs						
Transport	15.6	11.7	11.41	10.76	15.6	11.29
Travel	67.07	74.67	72.69	70.43	63.43	65.68
Communications	0.56	0.72	2.66	5.92	4.88	7.52
Construction	...	...	...	0.04	1.96	3.68
Computer and information services	...	...	0.39	1.18	1.18	2.21
Insurance	1.71	1.67	1.63	2.45	4.35	4.44
Financial services	...	...	0.22	1.45	5.13	4.86
Royalties and license fees	0.03	0.20	0.11	0.12	0.09	0.17
Other business services	10.54	7.21	7.93	5.25	1.60	2.48
Personal, cultural and recreational services	...	...	0.05	0.18	0.39	0.53
Government services n.i.e.	4.47	3.30	2.90	2.21	2.62	3.48
Source: On the basis of UNCTAD (2002) for the first four columns (1980-2000) and CARICOM (2005) for the last two columns (1992-2002).						

Table 16				
Exports of services				
Decomposition by Mode 1 and Mode 2 of services delivery				
1985 -2002				
	1980-1985	1985-1990	1990-1995	1995-2000
OECS				
Mode 1 Value (US\$ million)	22.67	104.50	888.70	306.83
Mode 2 Value (US\$ million)	174.17	378.33	1,004.04	854.17
Mode 1 Share in total service exports	11.09	20.80	22.88	26.17
Mode 2 Share in total service exports	88.91	79.20	77.12	73.83
Mode 1 Share in GDP	4.09	7.75	10.18	12.12
Mode 2 Share in GDP	26.68	29.14	34.40	34.14
MDCs				
Mode 1 Value (US\$ million)	743.2	765.3	1,079.2	1,444.0
Mode 2 Value (US\$ million)	1,524.8	2,268.0	2,838.3	3,447.0
Mode 1 Share in total service exports	32.96	25.33	27.31	29.57
Mode 2 Share in total service exports	67.04	74.62	72.69	70.43
Mode 1 Share in GDP				
Mode 2 Share in GDP				
Source: On the basis of UNCTAD (2002) for the first three columns (1980) and CARICOM (2005) for the last column.				

The analysis of trade flows between the CARICOM and the EU is constrained by the limited extent of data availability. The available data indicates, in line with the analysis above and as it is well known, that travel and other services are the main export services to the European Union. The bigger economies of Europe such as France, Italy and the United Kingdom are the most important receivers of services. In general contrary to the goods case the services balance is positive for CARICOM economies.⁵⁰

The available data also indicates that trade in health and education services between both economies are also of significant importance. As an example, Imani (2005) reports that 2% of work permits approved for nurses in Great Britain in 2001 were granted to Trinidad and Tobago nationals. More detailed data for teacher work permits shows that Jamaica, followed by Trinidad and Tobago, Guyana and Barbados are the main exporters of teachers to the United Kingdom (See Table 19 below).

⁵⁰ See, Willem te Velde. (2005) Special and Differential Treatment in CARIFORUM-EC Services Negotiations. With reference to Barbados, St. Lucia and Suriname. ODI (May 2005).

Table 17
Caribbean -15 services export to European countries (2003), €million
(to be inserted)

Table 18
Balance of Caribbean -15 services trade with European countries (2003), €million
(to be inserted)

Table 19
CARICOM countries' share of approved work permits for teachers in the
United Kingdom
2001-2003

	2001	2002	2003	Total
Jamaica	7.5	7.3	9.4	8.0
Trinidad and Tobago	0.8	0.7	0.8	0.8
Guyana	0.2	0.3	0.5	0.3
Barbados	0.3	0.1	0.1	0.2
St. Lucia	0.1	0.1	0.0	0.1
St. Vincent and the Grenadines	0.0	0.1	0.1	0.1
Antigua and Barbuda	0.0	0.0	0.0	0.0
St. Kitts and Nevis	0.0	0.0	0.0	0.0

Source: On the basis of Bennell P. (2004) Teacher Motivation and Incentives in Subsaharan Africa and Asia. Report for DFID, July.

8. The potential impact of the Cotonou agreement

From the point of view of the EU and ACP States, EPAs are not considered trade agreements in the traditional sense. EPAs are a development tool. Their main objective is to “help ACP countries to deal with the challenges of globalization by developing stronger regional economies.”⁵¹ EPAs recognize that unless ACP countries can overcome the limits imposed by capacity constraints and underdeveloped economic and social infrastructure they will not be able to reap the benefits from greater market access. That is, trade provisions included in trade agreements must be complemented with supply-oriented policies to build the required domestic capacity. In this sense the intention of the EPAs is to offer the flexibility allowing development needs to be taken into account.

The EU as well as ACP States recognize the benefits to be gained from EPAs. At the same time, both negotiating parties are cognizant that EPAs may have negative effects on ACP economies. The studies undertaken by the EU Commission point out that the reciprocity and the erosion of trade preferences envisaged by the Cotonou agreement and the EPAs will have important economic and social impacts.⁵² These may affect trade flows and the balance of payments through losses in export revenues and increases in imports. The losses in export revenue will result from the erosion of trade preferences. The decrease in tariffs may also lead to increase in imports. The agreements may also affect the budget constraint through reduced revenues as a consequence of the narrowing of the tax base. Furthermore, the changes in the trade regime will most likely affect employment⁵³ and economic growth.

⁵¹ EU Economic Partnership Agreements: putting a rogotous priority on development. 20 January 2005. Memo.

⁵² The Sustainability Impact Assessment mentions the potential vulnerability of ACPs manufacturing sector. The EU also recognizes the importance of the fiscal impact of trade liberalization. See also Annex 5 for a summary of the potential effects of Cotonou on African States.

⁵³ These effects are mentioned in the Impact Assessment. Annex to the Proposal for a Regulation of the European parliament and of the Council establishing accompanying measure for Sugar Protocol countries affected by the reform of the EU sugar regime. Commission of the European Communities. Brussels.22.6.2005.

At this stage of the negotiations, the estimation of the impact can only be a tentative exercise. This section presents results for two preliminary impact exercises. The first refers to the static impact using the standard methodology following a reduction in tariffs, that is trade creation versus trade diversion. The second exercise approaches the impact dynamically through a balance-of-payments growth model adapted to the Caribbean-European Union case.

8.1 Trade creation and trade diversion

The standard approach to analyzing the effects of a reduction in tariffs on trade is that of trade creation and trade diversion. In its origins the analysis of trade creation and trade diversion referred to the formation of a customs union. However the current trade literature uses both concepts to analyze the static welfare creation and diversion effects of the formation of a free trade area or to estimate the impact of tariff reductions.

Trade creation refers to a change in production of a good from a high-cost domestic source to a lower-cost source in a partner country. In this case given the fact that the product is not imported there is no loss in exports for any country. Trade diversion refers to a change in production from a lower-cost producer not belonging to the free trade area to a higher-cost producer belonging to the free trade area. This case assumes a discriminatory tariff reduction giving a member of a free trade area (FTA) a comparative cost advantage over a non-member by reducing its production costs. As a result the member increases its production efficiency over the non-member. A free trade area is said to be welfare improving if trade creation is greater than trade diversion. Note that a member of a free trade area can increase its welfare gain by individually reducing tariffs.

In his seminal contribution, Jacob Viner (1950) identified the conditions that if met by the FTA could improve its efficiency. These included, the geographical extension of the FTA, the level of the external tariff adopted by the members following the formation of the FTA relative to the previous tariff level, the degree of complementarity, differences in unit costs, and the level of tariffs prevailing outside the FTA.

The greater the geographical extension, the greater are the opportunities for trade creation. A greater geographical extension means a greater extension of the market and thus a greater scope for trade specialization and the generation of economies of scale. Also a greater geographical area can also involve a greater stock of natural resources implying the possibility of a more diversified export base.⁵⁴

Finally a greater geographical area can help to reduce transaction costs, when these are defined to include ‘transportation, communications, bureaucratic red tape and transshipping costs.’ The reduction in transaction costs increase profits and thus the incentives to export.

The relationship between the degree of complementarity and that of a trade diversion and trade creation of an FTA can be seen from different perspectives. A low degree of

⁵⁴ Recent findings also indicate that at least in the case of the United States, population is a factor that can account for greater innovation. As put by Hernández-Murillo (March, 2003): ‘Recently economists have found that densely populated areas are increasingly providing the best environment to facilitate the diffusion of new ideas, in addition to serving as the location for the production of goods. The reason is that the agglomeration of people and firms in urban areas promotes a faster exchange of information and ideas and this generates new technologies.’

complementarity in the production structures of States forming a FTA reduces the scope for trade diversion. Notwithstanding the formation of the FTA, member States will continue to trade with the rest of the world. In the same way a high degree of complementarity may enhance intraregional trade widening the possibilities for trade diversion.

Contrarily it may also be stated that countries with a low degree of complementarity are also more vulnerable to asymmetric shocks, thus reducing the possibilities for trade.

Lower tariff levels in a FTA reduce the possibilities of using tariffs to promote intraregional trade at the expense of extraregional trade and thus implicitly the use of subsidies to maintain inefficient production. Available empirical evidence indicates that certain regional trading blocs such as the Southern Common Market (Mercosur) or even CARICOM use their common external tariff to protect determinate products (motor vehicles in the case of Mercosur and agricultural products in the case of CARICOM). In other cases (i.e., NAFTA) the evidence indicates that tariffs have not been used as a tool to promote intraregional trade.

Other factors to take into consideration in analyzing the issue of trade diversion and trade creation are the presence of imperfect markets and the variations in the terms of trade. Trade creation can be enhanced when an FTA member faces high tariffs from the rest of the world in products with decreasing costs or when, due to size considerations, the scale of production is too small to yield an optimum scale of production. The existence of economies of scales can lead to trade creation through a production, consumption and cost reduction effects. The production effect allows the transfer of production to the lower cost trade partner. The consumption effect refers to the gain in the consumer surplus due to a decline in price. The cost reduction effect denotes a change to cheaper sources of supply.

More recently, Dunn and Muti (2000) identified three effects that could increase the efficiency of a free trade area: (i) a shift in output, where price is greater than average cost; (ii) a scale effect, where firms' average costs of production fall when output expands; (iii) increase in trade allows for the expansion of in the variety of final goods and intermediate inputs that are traded.

Finally, member States forming a free trade area and, more specifically, a customs union can impose a level tariff such as to provoke an increase in the terms of trade for the members of the union. In this case the welfare gains are at the expense of the rest of the world and this case does not consider the possibility of retaliation. An increase in the terms of trade via a rise in tariffs creates trade deviation and is thus not a welfare enhancing measure. There are, however, two points of view to this story.

The empirical studies analyzing the welfare effects of the formation of free trade areas find that the evidence is ambiguous. Panagariya (2000) distinguishes two approaches to this issue. The first is based on some type of general equilibrium models whereby starting from a base model with a given structure and parameters tariff barriers among trade partners are removed. The second type of approach is based on gravity equation estimates. Panagariya (Ibid. p.326) writes: 'Consider first the simulation approach. It is relatively easy to manipulate the structure of the model, functional forms and parameter values in these models to obtain one's

desired results.’ Regarding gravity equation estimates the criticism focuses on the fact that the success of the FTA is based on aggregate trade creation or diversion when in fact the question is to identify whether trade creation and trade diversion have occurred at the sectoral levels which, in fact, demands significant information requirements, which are difficult to obtain. Finally, it is to be noted that the analytical exercise in trade creation-trade diversion does not contemplate two crucial aspects for trade negotiations, trade in services which for the smaller economies of the Caribbean is the main form of international trade and the relationship between foreign direct investment and free trade areas.

Empirically the question of trade creation and diversion is analyzed using the SMART Simulation technique. In SMART in the case of trade between the Caribbean and the EU, trade creation refers to “the increase in the Caribbean’s imports from the EU owing to a decline in the relative price of these imports vis-à-vis domestically produced goods.” Following this logic there is an increase in the Caribbean’s total imports and a decrease in the Caribbean’s domestic production.

Trade diversion refers “to the increase in Caribbean’s imports from the EU due to a decrease in the relative price of these imports *vis-a-vis* imports from other countries resulting in a different geographical composition of imports.” In this case, imports from the European Union increase at the expense of imports from other sources. There is no variation in total imports from the Caribbean.

8.2 Trade creation and trade diversion at the aggregate and sectoral levels

The SMART methodology (See Annex) was used to compute the effects of trade creation and trade diversion at the aggregate and sectoral level. The analysis was undertaken for Caribbean imports from Europe since Europe applies duty free to the majority of its imports from the Caribbean.

Trade creation here refers to the increase in Caribbean imports from the European Union as a result of the reduction in tariffs. Implicitly in the analysis is the understanding that the increase of European imports occurs at the expense of Caribbean producers. For its part trade deviation refers to the displacement of imports in the Caribbean market from third countries. More specifically the analysis contemplated the analysis of trade deviation from the other major partner of the Caribbean, the United States.

At the sectoral level the following categories were included in the analysis: (i) agricultural materials; (ii) agricultural raw materials; (iii) chemicals; (iv) food; (v) fuels; (vi) machinery and equipment; (v) manufactures; (vi) ores and metals; and (vii) textiles.

The data set used comprised the period 1996 to 2003. The trade data was supplied by the United Nations Conference on trade and Development (UNCTAD) from the TRAINS database. The tariffs used in the analysis were the weighted tariff rates.

The elasticity of import demand as well as the elasticity of substitution are key parameters in the exercise influencing the results to a significant extent. Following the literature

on the subject (Stern et al.(1978); Cline et al. (1978) and Jachia and Teljeur (1999)) the SMART default value of -1.5 was used in both cases. In addition the scenario simulated the extreme case of full tariff reduction, that is, a full reciprocity scenario.

The results show that total trade creation resulting from the reciprocity scenario on the Caribbean market at the aggregate level amount to 5% of total current imports of the Caribbean from Europe.

Obviously by the logic of the SMART model the increase in trade creation would be lower if a smaller value of the elasticity of import demand and of the elasticity of substitution was used in the simulations.

In the same vein the countries that will register the most significant increases in trade creation, that is, of imports from Europe are those with the highest tariffs, namely Barbados, Bahamas, and Grenada. The sectors that will witness the greater increase in competition are those that are the most protected, namely light industry and primary sectors (agriculture and food sectors). These sectors in which the Caribbean already has an important installed capacity represent 16% of total Caribbean imports from Europe.

Table 20
Trade creation in favour of the European Union in terms of percentage of total imports of CARICOM

Product mane	Antigua and Barbuda	Barbados	Bahamas	Belize	Dominica	Grenada	Guyana	Jamaica	St. Kitts and Nevis	Saint Lucia	St. Vincent and the Grenadines	Trinidad and Tobago	Total
Agricultural Materials	14.0	32.5	10.9	14.9	12.3	47.3	15.3	18.0	8.6	13.9	7.2	12.4	18.0
Agricultural Raw Materials	-0.1	5.6	26.7	2.2	-0.4	21.8	3.7	-4.8	-7.0	-4.9	2.7	-5.4	-0.8
Chemicals	7.8	11.1	12.6	5.1	1.2	36.6	5.0	1.6	3.4	7.5	4.1	2.0	4.8
Food	14.1	33.4	10.7	14.9	12.5	49.0	15.5	18.2	9.9	15.2	7.4	13.0	18.5
Fuels	3.2	0.0	32.7	27.5	0.5	23.3	7.8	1.1	6.6	-5.5	3.8	11.4	7.5
Machinery & Transport Equipment	9.7	7.8	35.5	3.7	5.4	24.2	2.5	0.4	5.9	3.2	8.9	-3.9	0.6
Manufactures	9.0	9.6	23.5	4.2	7.5	28.6	3.5	1.3	5.5	5.1	7.6	-2.3	2.5
Miscellaneous Goods			-7.5									-0.5	-2.1
Ores & Metals	-2.2	1.3	29.9	3.8	-1.0	17.2	4.1	-6.7	-7.1	-6.3	-0.3	-4.2	-3.4
Other manufactures	7.6	11.1	20.3	4.2	15.1	29.6	4.0	3.2	5.4	7.2	7.4	-0.6	4.9
Textiles	13.6	11.4	24.9	9.2	12.4	40.4	0.8	6.2	17.4	15.5	11.3	0.2	9.3
Total non-oil trade	10.5	13.7	20.6	8.3	8.9	33.7	6.2	3.8	6.0	7.4	7.5	-0.7	5.0
Total	10.4	13.7	20.3	8.2	8.9	32.4	6.0	3.5	6.0	7.3	7.5	-0.5	4.9

Source: On the basis of WITS (2005)

Table 21
Trade diversion in terms of percentage of total imports

Product name	Antigua and Barbuda	Barbados	Bahamas	Belize	Dominica	Grenada	Guyana	Jamaica	St. Kitts and Nevis	Saint Lucia	St. Vincent and the Grenadines	Trinidad and Tobago	Total
Agricultural Materials	16.3	25.6	17.0	17.0	12.8	32.1	14.8	20.0	12.8	13.8	10.0	13.9	17.9
Agricultural Raw Materials	6.9	11.7	32.4	9.2	6.4	23.2	10.1	2.5	0.5	1.9	8.7	1.9	5.8
Chemicals	12.4	11.2	17.8	10.1	5.0	30.3	8.9	6.9	8.9	10.2	8.0	6.4	8.5
Food	15.9	25.3	16.7	16.8	12.4	32.1	14.6	19.8	13.6	14.5	9.8	13.8	17.7
Fuels	9.9	6.6	38.2	33.1	7.6	25.9	13.9	7.1	10.4	1.9	10.5	2.7	4.6
Machinery & Transport Equipment	12.2	9.7	39.9	9.9	9.6	18.3	6.8	5.4	10.8	6.7	12.0	2.2	5.4
Manufactures	12.6	11.1	28.6	10.1	10.5	23.0	7.6	6.5	10.2	8.5	11.1	3.2	6.9
Miscellaneous Goods												6.6	5.1
Ores & Metals	4.5	7.0	35.4	10.6	5.0	10.2	8.4	0.6	0.3	0.6	4.1	2.8	2.8
Other manufactures	12.5	12.5	25.7	10.1	16.5	26.0	7.8	8.6	9.9	10.7	11.1	4.4	9.0
Textiles	17.3	13.7	30.0	15.0	16.1	37.1	7.4	12.1	22.5	20.0	15.4	5.8	13.7
Total non-oil trade	13.7	13.6	25.9	13.2	11.3	25.8	9.3	8.4	10.7	10.0	10.7	4.2	8.6
Total	13.6	13.6	25.6	12.8	11.2	24.8	9.1	8.3	10.6	9.9	10.7	4.2	8.5
Source: WITS (2005)													

The results (see Tables 20 and 21 above) do not show very important effects on manufacturing and transport and equipment which account for roughly half of the imports of the Caribbean from Europe and which can have strong impact on productivity. Manufacturing and transport are two sectors for which, in general, the arguments for tariff liberalization outweigh those against it.

Thus overall the evidence show limited benefits for the trade creation potential as a result of tariff reduction. This conclusion is further compounded by the results of the trade diversion exercise.

The results for the trade diversion exercise show that trade diversion, which occurs at the expense of NAFTA countries, is greater than trade creation. Trade diversion represents close to 9% of total current imports of the Caribbean and close to twice the figure for trade creation. Trade diversion is also greater for light industry and primary products (food and agricultural materials). At the country level trade diversion is most significant for the Bahamas and Grenada (26% and 25% of current imports). In the case of Grenada trade creation surpasses trade diversion while the opposite result holds for the Bahamas.

8.3 A dynamic analysis of the impact of the EPAs

The SMART simulation are static, that is they do not take into account investment creation or diversion, X-efficiency effects or growth effects which may actually be the most important consequences of the Cotonou and EPAs.

This subsection makes an attempt at measuring the dynamic effects. The dynamic effects are captured by analyzing the impact of the tariff reduction on the equilibrium rate of growth. The analysis is founded upon the fact that smaller economies are balance-of-payments constrained economies. Countries are balance-of-payments constrained in the sense that their performance in overseas markets, and the response of the world financial markets to this performance, constrains the rate of growth of the economy to a rate which is below that which internal conditions would warrant (McCombie and Thirlwall, 1999). As a result, the equilibrium rate of growth of an economy is that rate of growth, which maintains the equilibrium in the current account or in the basic balance of payments.

According to the methodology here presented the equilibrium rate of growth of an economy is a function of a set of predetermined policy variables. These include, price and income elasticities, the rates of growth of the trading partners, the import and export shares and the changes in terms of trade and tariffs.⁵⁵

The long-term equilibrium growth rate of selected CARICOM economies was determined using a balance-of-payments-constrained growth model (See Annex) with and without the terms of trade effect. The estimations were carried out in real terms. The estimation that took into account the terms of trade effect provided the benchmark to obtain rates of growth of output under two tariff reduction scenarios.

Table 22
Results of the simulation for the equilibrium rates of growth

Countries	Terms-of-trade	Income elasticity	Actual rate of growth	BPC Growth rate I	BPC Growth rate II	Scenario I	Scenario II
Barbados	2.09	2.92	1.14	1.91	1.08	0.87	0.91
Dominica	0.68	2.65	2.50	3.03	3.26	3.45	3.52
Grenada	0.84	1.19	3.68	4.34	5.20	4.92	5.01
Jamaica	2.31	0.81	1.59	2.91	4.85	3.45	3.51
St. Kitts and Nevis	0.18	1.72	4.58	4.44	4.45	4.41	4.50
Saint Lucia	0.66	1.22	3.79	4.42	4.93	4.92	5.01
St. Vincent and the Grenadines	0.01	1.95	4.47	2.81	2.83	2.83	2.88

Note:

The actual rate of growth refers to the average rate of real GDP growth

The BPC growth rate I refer to the rate of GDP growth which is consistent with the current account equilibrium. It does not consider the terms of trade effect.

The BPC growth rate II refers to the rate of GDP growth which is consistent with the current account equilibrium taking into account the terms of trade effect.

⁵⁵ The price and income elasticities were obtained through econometric cointegration techniques. Cointegration provides an empirical analysis of long-run economic relations that take into account the potential non-stationary properties of the data. That is, it captures the fact that the time series processes may not have a constant mean or a bounded variance. The standard method to allow for non-stationarity in the estimation of long-run economic relations is to apply cointegration methods. The first step of this method requires verifying that the relevant variables have compatible orders of integration. The order of integration of a stochastic variable $X(t)$ is defined as the number of times it must be first-differenced to obtain a stationary series. This task is here done through the application of the conventional and the augmented Dickey-Fuller tests. Once such compatibility is checked, the next step consists of estimating the number of stationary linear combinations (so-called cointegration vectors) of the relevant variables. If no such combination is identified the variables are said to be not cointegrated; in other words there is no stable long-run linear relation between them. On the other hand, if at least one such combination exists, the variables are said to be cointegrated and the estimated coefficients are interpreted as the long-run linear multipliers of the relevant regressors. To estimate the number, if any, of such cointegrating vectors we applied Johansen's methods. They require to first specify a vector autoregressive (VAR) system with the set of relevant variables and then to estimate the number of long-run equilibrium relationships between them. The rest of the variables were obtained from available empirical evidence. Simple introductions to unit-root testing and cointegration analysis may be found in Cuthbertson (1992) and Charemza and Deadman (1992) and Enders (1995).

The first scenario hypothesized a significant tariff reduction of 20% applied to Caribbean imports from Europe. The second scenario maintained the 20% tariff cut and added an increase in the rate of growth of real export of 2%. While the first scenario focuses purely on changes in trade regime, the second scenario also takes into account the possibility of an increase in the competitiveness of Caribbean exports to Europe, that is, it also takes into account the development-related aspect of EPAs.

The computations took into account the market share of Europe and the percentage of trade that pays import duties. The results are presented in Table 21 above. Several points are worth mentioning.

First, with the exceptions of Barbados and Jamaica, in all the cases considered the income elasticity tended to be greater and outweigh the terms of trade coefficient. This means that for the most part income effects predominate over price or substitution effects. The result implies that if price effects are not very important tariff changes may not have a significant effect on the demand for imports or on growth. The main driver of imports is income.

In addition this finding is also important to ascertain the fiscal effects of trade liberalization. If imports are not sensitive to price variations, the import tax base will not be affected by price changes. The tax base will respond to changes in income while the tax rate will respond more to tax policy considerations. Tariff reductions will translate into a decline in government revenue depending on if the rate of growth of the economy does not change or if it decreases. The evidence thus far shows that the importance of international trade taxes have declined as a result of the decline in imports and in spite of the increase in the effective tax rates (See Tables 22 and 23 above).

Second, as shown in Table 21, the actual rate of growth is generally below the rate of growth, which is consistent with balance of-payments equilibrium. In other words, CARICOM countries have expanded at rates of growth below those dictated by the foreign exchange constraint. That is Caribbean countries have space to expand, demand and grow without endangering their external position.

Third, the first scenario which hypothesizes only a tariff reduction has a negative effect for all of the economies considered with the exception of Dominica and St. Vincent and the Grenadines. The magnitude of the negative effect is different. The consequent reduction in the equilibrium rate of growth is highest for Grenada and Jamaica (-0.28% and 1.4% percentage points of GDP). It is smallest for St. Kitts and Nevis and Saint Lucia (-0.04% and -0.01% percentage points of GDP).

Fourth, the second scenario which, combines the tariff reduction with an increase of 2% in real export growth results in an increase in the equilibrium rate of growth for all economies with respect to the first scenario. As a result, the growth in exports offsets, as would be expected, the tariff reduction.

Furthermore with respect to the rate of growth obtained using the balance-of-payments model with the terms of trade effect, the results show that in the case of Barbados, Grenada and

Jamaica the overall effect is to reduce the equilibrium rate of growth (-0.17%, -0.19% and -1.34% percentage points of GDP growth, respectively). In Barbados and Jamaica this is due to the size of the terms of trade coefficient. Contrarily, in the cases of Dominica, St. Kitts and Nevis, Saint Lucia and St. Vincent and the Grenadines, the overall effect is an increase in the equilibrium rate of growth (0.26%, 0.05%, 0.08% and 0.06% percentage points of GDP growth, respectively). For these economies the rise in export growth more than offset the effect of the decline in tariffs which, as mentioned in the previous paragraph, was significant not for most of these economies.

The results provided by the dynamic simulations point to the fact that the impact of the tariff reductions contemplated by a free trade agreement may not be very significant. The static results of the SMART methodology also point in that direction. In addition, the results indicate that a slight increase in exports brought about by an improved competitiveness as envisaged by the EPAs is more than sufficient in most cases to offset the effects on the rate of growth brought about by a reduction in tariffs.

Sectoral and country studies undertaken to show the economic and social impact of the EPAs and of changes in the existing trade regime between ACP countries and Europe also indicate that the overall negative effects may not be for the most part significant and that there will be positive effects that have to be taken into consideration. The results of three studies are presented. The first deals with the impact of the proposals of the European Commission to reform the sugar regime on ACP countries.⁵⁶ The second focuses on the impact of EPAs on the economy of Trinidad and Tobago.⁵⁷ The third centers on the effects of EPAs on the tourism sector in Jamaica and Trinidad and Tobago.

The first study referred to above presents two alternative scenarios for the reform of the sugar trading regime, the July 2004 and June 2005 proposals. In addition the study considers the possibility that ACP countries are granted unlimited access to the EU market from 2008 and alternatively that the current system of quotas is maintained after the year 2008. All estimates are based on the current cost structure.

Regardless of the proposal adopted, following the reform, the production of sugar will not be profitable for St. Kitts and Nevis (which has ceased production), Barbados, Belize, Jamaica and Trinidad and Tobago. The consequent impact will be important for Belize since sugar contributes 10% to its GDP (See table 1 above). It may also have an important effect on employment since for Belize, the sugar sector employs close to 13% of the labour force. However, in the rest of the economies the impact will not be as significant. Sugar is not a main contributor to the generation of output, employment or foreign exchange earnings.

In the case of Trinidad and Tobago, it is expected that the implementation of the EPAs will have an effect on the manufacturing sector. However, the effect is projected to be small. It includes a 1% loss in employment in the manufacturing sector and less than 0.7% loss in government revenue.

⁵⁶ LMC International (June 2005)

⁵⁷ Imani Deevlopment (May 2005)

The third study assesses the potential economic, social and environmental impacts of an EPA on the tourism sector in Jamaica and Trinidad and Tobago. The study undertaken under the Sustainability Impact Assessment of the EU-ACP EPAs simulates a scenario based on the full implementation of the CSME, and the full liberalization of all tourism subsectors under modes 1,2 and 3 and complete as possible under mode 4. The simulation of the impact is carried out under the important assumption that the EPAs will increase foreign savings and translate into an increase in physical capital. As a result GDP growth increases by 0.75% in the case of Jamaica and by 0.42% in the case of Trinidad and Tobago. Greater growth translates into higher levels of government revenue. In addition, greater tourism receipts have a positive effect on the external accounts and on employment.⁵⁸

9. Conclusion

The Cotonou Agreement overhauls the relationship between ACP countries and Europe. Its scope is very broad and its main objective, the eradication of poverty consistent with the objectives of sustainable development and the gradual integration of ACP countries into the world economy, is ambitious. One of the most important changes brought about by the Cotonou Agreement is that in consonance with WTO principles it replaces non-reciprocity by ‘reciprocity within flexibility’ as the basis for trading arrangements.

In order to ensure the smooth and gradual integration of ACP States into the world economy, the Cotonou agreement conceives economic and trade cooperation as based on a strengthened and strategic partnership between both negotiating parties. The agreement recognizes that the new trading arrangements should be introduced gradually and that a preparatory period of adaptation is needed. During the preparatory period, non-reciprocal trade preferences will be maintained. In addition during the preparatory period EPAs will be negotiated. Their main aim is to establish a timetable for the removal of trade barriers between the negotiation parties. The Cotonou agreement states that the negotiations shall take into account the level of development and the socio-economic impact of trade measures on ACP countries as well as their capacity to adapt and adjust to the liberalization process.

The EPAs are trade agreements that go beyond the conventional sense and even second-generation trade agreements. EPAs seek to promote economic development by addressing not only trade issues but also the limits imposed on ACP countries by capacity constraints and underdeveloped economic and social infrastructure. The EPAs are negotiated on a regional basis so that regional integration and world integration are part of the same process.

The EPA negotiations between CARIFORUM and the EU are scheduled in four different phases. Two of the phases have been completed and the negotiating parties are ready to embark on the third phase, which will probably start in a definitive form following the Hong Kong WTO ministerial meeting, which will take place in the first half of December 2005.

⁵⁸ See Sustainability Impact Assessment (SIA) of the EU-ACP Economic Partnership Agreements. See also, Savard, L. (2005) Impact Analysis on Tourism Sector: The Jamaican and Trinidad and Tobago Case Studies. A Computable General Equilibrium Analysis.

The timetables for trade liberalization and the scope of trade liberalization have not yet been negotiated. As a result the measurement of the effects of EPAs can only be a tentative and very preliminary exercise. ACP countries have, however, expressed concerns about the effects of trade liberalization. The validity of these concerns has been recognized by the EU and by some of the impact studies that have been undertaken.

These include the loss of export earnings due to the erosion of trade preferences, the potential increase in imports due to the decline in tariffs, the vulnerability of some sectors to increased competition including not only the agricultural but also the manufacturing sector. In addition the potential costs of job losses and the social dislocation have also been pointed out as potential negative effects of EPAs.

At the same time EPAs are expected to induce greater flows of foreign savings. If properly channeled a greater level of foreign savings may result in expanding productive capacity leading to a higher level of economic growth. A greater level of foreign savings would soften the external constraint and growth would allow the expansion of government revenue.

The trade analysis presented in the paper shows that CARICOM exports to the EU represent roughly a quarter of its total exports. At the aggregate level CARICOM economies have lost market share in the EU. The analysis also shows that the loss in market share affects mainly primary and agricultural commodities and that in fact CARICOM has gained market share in products that have a higher degree of value added and technological content.

The dynamic simulations presented in this document show that the effect of tariff reductions on output growth will not be very significant. They also show that countries have space to improve their growth performance without endangering their external position. This has also important implications for fiscal policy because that tariff reduction may not have an important negative effect on government revenue.

From the point of view of this document, EPAs will have three important effects on CARICOM economies.

First, they will provide an incentive for CARICOM to accelerate and perfect its regional integration process. Regional integration is seen as a pre-condition for extraregional integration. The region can be a training ground for firms to become competitive at the extraregional level. The empirical evidence shows there is no absolute divide between the firms that export intraregionally from those that export extraregionally. That is, according to the results there is scope for expanding trade through Learning-by-Doing processes where the Learning-by-Doing would occur at the intraregional level allowing firms to acquire the skills and competitiveness to export to extraregional trade partners.

The challenge is to ensure that the process of regional integration adapts to the reality it is trying to change and addresses the needs of the signatory member States. One key issue that needs to be addressed in this regard is how to transform the impending polarization at the country and firm level into a growth pole for the region.

Second, the EPAs will accentuate the economic tendencies that are entrenched in CARICOM. These include the stagnation of agriculture, the virtual disappearance of the manufacturing sector in some of the smaller States and the continued dynamism of the services sector. EPAs should ensure that its provisions do not lead to a process of economic duality, marginalisation of the traditional sectors of the economy, and annihilation of the manufacturing sector. Key to avoid this outcome is to ensure the crowding in of foreign and domestic investment. As it currently stands foreign direct investment has not been able to translate into greater domestic investment. In other words foreign savings have not resulted in greater levels of investment.

Third, the EPAs will also provide an opportunity for CARICOM countries to restructure or to continue to restructure their economies to adapt to a changing environment. Firms in the Caribbean have begun a process of restructuring of production aimed at reducing costs. Firms expect to achieve a reduction in costs via; (i) the expansion of their installed capacity; (ii) a change in the methods of production; (iii) diversification in their product lines.

Both the expansion of capacity and the diversification in the lines of production is under consideration by firms that are capital intensive. The change in method of production corresponds to a strategy adopted by smaller firms that, by definition, are more flexible and for which it is not as costly, as for firms that are capital intensive, to implement such a change.

Restructuring involves what is termed a crucial decision. Economic agents engage in crucial decisions when they cannot exclude from their mind the possibility that the very act of performing the experiment may destroy forever the circumstances in which the decision was made. In other words, crucial decisions are an act of creative destruction. They destroy the environment in which the decision was made so that the same process cannot be repeated. This is the underlying reason that justifies the pressing need to ensure that restructuring accomplishes its objective.

ANNEXES**Annex I: Boxes 3 to 6 and tables 22 to 23**

Box 3	
Evolution of the cooperation between the European Union and ACP States	
1957	Belgium, France, Italy, Luxembourg, the Netherlands and West Germany sign the Treaty of Rome creating the European Economic Community (EEC). The treaty includes a legal provision for a specific European cooperation programme
1963	African States gain independence, EEC develops first generation economic cooperation arrangements, mainly with French-speaking African countries (Yaounde conventions)
1973	The UK joins the EEC, bringing along its former colonies in Africa, the Caribbean and the Pacific
1975	Lome I Convention (1975-80), the first major aid and trade cooperation arrangement between Europe and the ACP
1980	Lome II Convention (1980- 85)
1985	Lome III Convention (1985 -1990 includes for the first time a human rights clause
1990	Lome IV Convention (1990 -1995)
1990-1995	Lome IV bis Convention (1995 -2000) reinforces political cooperation and introduces possibility for suspending aid in cases of grave violation of agreed values and principles
1996	EC starts informal consultations on the future of ACP-EC cooperation (green paper)
1998 -2000	Negotiations for a successor arrangement to Lome
June 2000	Cotonou Agreement signed in Cotonou, Benin
April 2003	The Cotonou Agreement enters into force
Source: The Cotonou Agreement: User Guide For Non-State Actors ECDPM Publication -February 2004	

Box 4 Essential traits of the Cotonou Agreement	
What	The Cotonou Agreement is a Preferential Trade agreement between the EU on the one hand, and the 76 ACP States on the other. The agreement contains provisions on economic and trade cooperation, financial facilities, and political cooperation.
Why	To promote economic growth and development. The EU hopes that increased trade with the ACP States will foster integration into the world economic system, as well as promote competitiveness, efficiency, and increased investment in resources.
When	The agreement was preceded by the Lome Conventions which began in 1975 and were to last for a period of 25 years. Negotiations for the successor arrangement to Lome took place between 1998 and 2000, and the Cotonou Agreement was signed in Cotonou, Benin, in June 2000. The Cotonou agreement came into force in April 2003, following a three-year transition period due to ratification deadlines. It will last until 2020.
Benefits to ACP states	Large EU market size; goods are exempt from tariffs faced by non-ACP exporters
Benefits to EU	Producers have a reliable and cheap supply of primary products (e.g. sugar). EU consumers are able to buy cheap goods.
Organisation:	
The Actors	Article 4 emphasizes that the ACP States have the sovereignty to determine the development principles, strategies and models of their economies and societies. The agreement also recognizes the important contribution of non-State actors in the development process. It provides that non-State actors will be informed and involved in policy and strategy consultations; involved in implementation; be supported with financial resources to support local development initiatives; and be provided with capacity-building support to reinforce their capabilities.
Representative Bodies	The EU is represented by the European Commission. The ACP States are represented by the ACP Secretariat. The ACP Secretariat is a legal body located in Brussels; it was signed into force at the Georgetown Agreement, in Georgetown, Guyana in 1975. The joint institutions of the Cotonou Agreement are the Council of Ministers, the Committee of Ambassadors and the Joint Parliamentary Assembly.
Joint Institutions	
Council of Ministers	The Council of Ministers is composed of the members of the Council of the European Union and members of the Commission of the European Communities, and a member of the government of each ACP State. The Council generally meets once per year. The role of the Council is to conduct political dialogue; to adopt policy guidelines for the implementation of the Agreement; to resolve obstacles to its efficient implementation; and to ensure the smooth functioning of the consultation mechanisms.

Committee of Ambassadors	<p>Composed of the permanent representative of each Member State to the European Union and a representative of the Commission, and the head of mission of each ACP State to the European Union.</p> <p>Its role is to assist the Council of Ministers in its tasks and to carry out any mandate entrusted to it by the Council; to monitor implementation of the agreement and progress in achieving its goals. The Committee meets regularly; to prepare the Council sessions and whenever else necessary.</p>
Joint Parliamentary Assembly	<p>Composed of equal numbers of EU and ACP representatives. The members of the Joint Parliamentary Assembly are members of the European Parliament and members of parliament of each ACP State (or representatives thereof). The Assembly meets twice a year in plenary session.</p> <p>The Assembly is intended to be a consultative body. Its role is to promote democratic processes through dialogue and consultation; to facilitate greater understanding between the peoples of the EU and the ACP States and raise public awareness of development issues; to discuss issues pertaining to development and the ACP-EU Partnership; and to adopt resolutions and make recommendations to the Council of Ministers.</p> <p>The Agreement dictates that the Assembly will organize regular contacts with representatives of the ACP-EU economic and social partners and other actors of civil society, in order to obtain their views on the attainment of the objectives of the Agreement.</p>
Economic and Trade Provisions:	
Trade	<p>Under the Lome Conventions, ACP countries were allowed free-trade access to EU markets. Goods from ACP countries were exempt from tariffs that other non-ACP exports face in bringing goods into the EU.</p> <p>In Article 36, both parties agree to progressively reduce barriers to trade between them, to comply with WTO rules.</p> <p>EPAs will replace existing trade relations when they are implemented in January 2008.</p>
EPAs	<p>Article 37 provides that Economic Partnership Agreements (EPAs) will be negotiated during the preparatory period (2002 – 2007). EPAs would establish reciprocal free trade areas that are compliant with WTO rules. Formal negotiations began in September 2002 and will end by 31 December 2007 at the latest. The EPAs will come into force on 1 January 2008, unless earlier dates are agreed upon by both parties.</p> <p>If a non-LDC decides not to enter into a reciprocal EPA, the agreement states that there will be an examination of all alternative possibilities, to provide a new framework for trade which is equivalent to their existing situation and is in conformity with WTO rules.</p>
Trade in Services	<p>The European Community pledges in Article 41 to give special consideration to ACP interests.</p>

The Joint Ministerial Trade Committee	<p>Article 38 dictates that a Joint ACP-EC Ministerial Trade Committee will be established. It will be comprised of representatives of both parties, and will meet at least once per year.</p> <p>The Committee will pay attention to current multilateral trade negotiations, and assess the impact of liberalization on EU-ACP trade and on ACP economic development. The Committee will make recommendations for amendments to the agreement, to preserve the benefits of EU-ACP trade.</p>
Economic Development	<p>The Agreement emphasizes that the development strategies are to be locally owned by each ACP State, and will incorporate an integrated approach focusing on economic, social, cultural, environmental and institutional elements.</p> <p>Article 20 dictates that EU-ACP cooperation strategies will focus on achieving economic growth, development of the private sector, strengthening of domestic institutions for efficient and competitive market economies, regional cooperation, environmental sustainability, and preservation of the natural resource base.</p>
Financial Resources	
European Development Fund (EDF)	<p>The European Development Fund (EDF) is the financial resource through which the EU pays for cooperation activities organized under EU-ACP cooperation programs. The ninth EDF pertained specifically to the Cotonou Agreement; 15.2 billion euro was made available, of which 74.3% was in the form of grants, and 25.7% in the form of loans.</p>
Eligibility for Financing	<p>ACP States, regional bodies and joint bodies are eligible for financial support provided by the Agreement.</p> <p>Subject to the agreement of ACP States concerned, the following may also be eligible for financial support: national or regional public or semi-public agencies, departments or local authorities of ACP States, ACP financial institutions and development banks, private organizations in ACP States, and enterprises in EU States.</p>
The Scope of Financing	<p>Financing is intended to support debt reduction, macroeconomic and structural reforms; sectoral reforms; institutional development and capacity building; technical cooperation; and humanitarian and emergency assistance. Financing also includes funding for projects; credit lines, guarantee schemes and equity participation; budgetary support for the ACP States; and for administration and supervision of projects.</p>
ACP-EC Development Finance Cooperation Committee	<p>Article 83 establishes the ACP-EC Development Finance Cooperation Committee as a group within the Council of Ministers. At least once a year, The Committee is supposed to examine whether the objectives of development finance are being attained.</p>
Political Dimension	<p>Articles 96 and 8 make provisions for political dialogue, specifically in the areas of human rights, democratic principles and the rule of law. If either party deems that the other is not fulfilling its commitment to human rights, democracy or the rule of law, that party can supply information to the Council of Ministers, in hopes of finding an acceptable solution to both parties. If the parties cannot come to a mutual agreement, or if the violating party is unwilling to negotiate, appropriate measures can be taken in accordance with international law.</p>

	Article 11 addresses peace-building strategies and conflict resolution. It aims to prevent conflicts by addressing their root causes in a targeted manner. The article supports equality of opportunity, democratic legitimacy, good governance, and building civil society. Relevant issues include careful management of scarce natural resources, demobilization of combatants and reintegration into society, child soldiers, landmines, spread of weapons, and setting suitable limits to military expenditure and the arms trade. Financial resources will be provided in situations of violent conflict.
Effects of EU policies on the Cotonou Agreement	Article 12 dictates that if the Community intends to change a policy which affects the interests of ACP States, the ACP Secretariat will be notified ‘in good time’ of the impending change. The ACP States may also place a request for information. The ACP States can then consult, and offer suggestions for amendment. The European Commission is not obligated to compromise, and the final decision rests with the European Commission and not the Council of Ministers.
Education	In Article 13 the parties pledge to develop cooperation programs to facilitate the access of students from ACP States to education, in particular through the use of new communication technologies.
Reform	
Revision Clause	Article 95 is a revision clause allowing adaptations to be made every five years. The first revision was signed in June 2005. Provisions on economic cooperation and trade are subject to a separate procedure. If any party wishes to make an amendment to the agreement, they must notify the other party at least 12 months before the expiry of each five-year period of review. The other party then has two months to analyze the proposed amendments; negotiations between the two parties will begin 10 months before the review period is due to expire.
Accession	Article 94 is a provision allowing for independent states to join the agreement. A request for accession may be made by an independent state whose ‘structural characteristics and economic and social situation are comparable to those of ACP States’. Accession depends on the approval of the Council of Ministers. The State concerned shall enjoy the same rights and be subject to the same obligations as the ACP States.

Box 5
The Banana Case

In 1997, Ecuador Guatemala, Honduras, Mexico and United States challenged the European Community regime for the importation, sale and distribution of bananas established in 1993. This regime consisted of the establishment of a tariff quota of 2 million tons allocated to Latin American countries and non-traditional ACP bananas. The tariff quota increased to 2.1 and 2.2 million in 1994 and 1995 respectively. Also an additional tariff quota of 353,000 tons was introduced in the same year. The increase in the tariff quota was justified on the grounds of the enlargement of the European Community. The quantities allocated to traditional ACP banana exporters totalled 857, 700 tons. The tariff applied to Latin American producers within the quota was 75 ECUs per tone and a zero duty for ACP countries. This regime was found to be illegal by the WTO dispute settlement body. In 1999, the European Union implemented a new regime that was still found to be WTO incompatible. The United States and Ecuador were granted the right by the dispute settlement body to suspend tariff concessions to the European Union. A solution was finally reached in 2001. The Agreement consisted of the adoption of a tariff-only regime by the European Union to be implemented no later than January 1, 2006. In the interim, the regime to be applied consists of a two-phased scheme. The first phase consists in a modified import regime based on the historical allocation of licenses and entered into force in July 2001. It consists of three tariff rate quotas, A, B, and C. Quota A, is set at 2, 200, 000 tons. Quota B is set at 353, 000 tons. Quotas A and B are open for imports originating in all third countries. Quota C (850, 000 tons) is open to imports originating in ACP countries. In the second phase, which starts in January 2002, 100, 000 tons are to be transferred from C quota to the B quota. The remaining 750, 000 tons will be still reserved for ACP bananas. At the Fourth Ministerial Conference in Doha, WTO waivers were granted regarding obligations under Article I (permitting continued tariff preferences for ACP imports) and Article XIII of the GATT (permitting the setting aside of the C quota for ACP bananas).

Source: European Community (2000). European Community Council Regulations No.2587/2001 (19 December, 2001); No.896/2001 (May, 2001). WTO. WT/MIN(01)/15 and WT/MIN/(01)/15 (14 November, 2001).

Box 6				
Comparison of the quota/tariff structure under the previous and current Banana Import Regime				
	Quota (Tons)	Remarks	Tariff rate	Remarks
1993 banana import regime				
Latin American and non-traditional ACP bananas	2, 000, 000	Increased to 2.1 and 2.2 million following the Banana Framework Agreement. In 1995, the EC following its enlargement introduced an additional tariff quota of 353 000 tones.	75 ECU per ton for Latin American countries and 0 for ACP countries	Within quota
Traditional ACP banana suppliers	857, 700		75 ECU per ton for Latin American countries and 0 for ACP countries	Within quota
Modification of the 1993 import regime in 2001				
Quota A. Quota A is open for imports of products originating in all third countries	2, 200, 000	The EC Council Regulations which amended the 404/93 regulation introduced a three tiered quota system (Quotas A, B and C)	75 ECU per ton for Latin American countries and 0 for ACP countries	
Quota B. Quota B is open for imports of products originating in all third countries	453, 000		75 ECU per ton for Latin American countries and 0 for ACP countries	
Quota C. Quota C is open for imports of products originating in ACP countries.	750, 000		0 for ACP countries	
Sources: Official Journal of the European Communities. Council Regulations (EC), No. 2587/2001 (December, 19, 2001); No. 896/2001 (May, 7, 2001); No.216/2001 (January, 19, 2001)				

Table 22
Import tax classification and presentation by country
1980-2004

Country	Presentation format	Import tax dependency Percentage of total tax revenue			
		1980-1990	1990-1995	1995-2000a/	2000-2004
OECS	International trade and transactions	58.3	59.1	57.7	55.0
	Import duties	....	....	28.2	25.4
	Consumption tax	....	....	17.9	15.4
	Customs service charge	....	....	7.2	8.5
	Foreign currency levy	....	....	0.7	0.6
Antigua and Barbuda	International trade and transactions	63.8	65.8	66.5	61.7
	Import duties	...	...	19.5	16.5
	Consumption tax	...	...	28.7	23.7
	Customs service charge	...	...	9.0	12.6
	Foreign currency levy	....	...	2.8	2.4
Bahamas	International trade and transactions		67.1	64.9	63.1
	Import tax		53.6	51.1	49.6
	Stamp tax from imports		11.8	12.3	11.8
	Export tax		1.7	1.5	1.7
	Stamp tax from exports		0.0	0.0	0.0
Barbados	Import duties		9.34	8.80	9.51
Belize	International trade and transactions		58.3	41.1	43.3
Dominica	International trade and transactions	62.8	57.0	53.7	51.4
	Import duties	....	....	14.0	12.6
	Foreign exchange tax	...	....	0.0	0.0
	Consumption tax	...	....	32.6	29.2
	Customs service charge	....	....	2.4	4.2
Grenada	International trade and transactions	54.0	60.2	61.1	60.2
	Import duties	....	....	13.7	13.4
	Foreign exchange tax	...	...	0.1	0.1
	Consumption tax	...	...	34.2	33.2
	Customs service charge	....	....	10.3	10.3
Jamaica	International trade and transactions	....	25.7	29.8	27.9
	Custom duty	....	12.3	10.7	9.6
	Stamp duty	....	2.1	1.0	0.8
	Travel tax	....	1.4	1.9	1.5
	General custom tax	....	9.3	12.6	10.8
	Service custom tax	....	0.5	3.6	5.2
St. Kitts and Nevis	International trade and transactions	66.3	55.5	51.6	49.7
	Import duties	....	....	20.8	16.6
	Foreign exchange tax	....	....	0.0	0.0
	Consumption tax	....	....	21.9	23.4
	Customs service charge	....	....	5.4	8.0
St. Lucia	International trade and transactions	57.7	59.1	55.4	55.4
	Import duties	....	....	18.8	14.6
	Foreign exchange tax	....	....	0.0	0.0
	Consumption tax	....	....	23.8	24.2
	Customs service charge	....	....	7.8	8.0
St. Vincent and the Grenadines	International trade and transactions	55.4	52.0	50.3	49.3
	Import duties	....	....	10.8	10.7
	Foreign exchange tax	....	....	....	....
	Consumption tax	....	....	30.5	29.1
	Customs service charge	....	....	5.7	7.3
Guyana	International trade taxes		11.16	11.32	9.94

Note: a/ For most counties data is available for 1997-2000 and for 1998-2000
Source: On the basis of official data.

Table 23
Trade taxes as percentage of GDP as imports and imports as percentage of GDP
1981-2004
OECS

Country	Variables	Averages				CC1 b/	CC2	CC3
		1985-1990	1990-1995	1995-2000	2000-2004 a/			
OECS	Trade taxes/GDP	12.67	12.21	12.45	12.23	0.25	0.33	-0.83
	Trade Taxes/Imports	0.00	22.73	24.45	25.69			
	Imports/GDP	0.00	53.83	50.93	47.64			
Antigua and Barbuda	Trade taxes/GDP	11.86	11.52	12.04	10.91	0.08	0.21	-0.94
	Trade Taxes/Imports	16.08	19.11	21.60	23.09			
	Imports/GDP	75.37	60.34	55.85	47.41			
Dominica	Trade taxes/GDP	15.19	13.17	12.89	12.67	0.17	0.63	-0.65
	Trade Taxes/Imports	29.70	26.04	27.21	29.81			
	Imports/GDP	51.70	50.94	47.42	42.75			
Grenada	Trade taxes/GDP	13.04	13.84	13.68	13.72	0.91	-	-0.66
	Trade Taxes/Imports	25.43	30.19	27.66	27.35			
	Imports/GDP	51.40	45.79	49.45	50.32			
St. Kitts and Nevis	Trade taxes/GDP	11.06	8.99	11.33	11.36	0.46	0.33	-0.67
	Trade Taxes/Imports	17.78	17.65	23.48	23.88			
	Imports/GDP	62.21	51.70	48.48	48.19			
St. Lucia	Trade taxes/GDP	13.02	13.41	13.01	12.67	0.43	0.17	-0.81
	Trade Taxes/Imports	23.68	24.50	27.16	27.96			
	Imports/GDP	55.02	54.90	47.97	45.46			
St. Vincent and the Grenadines	Trade taxes/GDP	14.56	11.78	11.95	12.39	-0.04	0.71	-0.72
	Trade Taxes/Imports	23.68	22.40	24.01	27.34			
	Imports/GDP	61.59	52.88	50.01	45.39			

Note: a/ The figures for Grenada are for years 2000-2002

b/ CC1 is the correlation coefficient between trade taxes/imports and trade taxes/GDP.

CC2 the correlation coefficient between trade taxes/GDP and imports/GDP.

CC3 the correlation coefficient between trade taxes/imports and imports/GDP.

The Correlation Coefficients are given for 1982-2004. Exceptions are the OECS (1990-2004) and Grenada (1982-2002)

**Annex II:
Measuring the static impact through the smart methodology**

According to the SMART methodology trade creation is formally specified as:

$$(1) TC = \psi * M_{eu} * ((\tau_{eu1} - \tau_{eu0}) / \tau_{eu0})$$

Where:

M_{eu} =merchandise imports from the European Union.

ψ = price elasticity of the demand for imports ($\psi < 0$).

τ_{eu1} = tariff rate applied to imports from the European Union after tariff reduction

τ_{eu0} = tariff rate applied to imports from the European Union before tariff reduction

According to Eq. (1), trade creation is proportional to imports and to the price elasticity of the demand for imports.

For its part trade diversion is equal to:

$$(2) TD = [M_{eu} * M_{rw} * [d(p_{eu}/p_{rw}) / (p_{eu}/p_{rw})] * \sigma_{eu,rw}] / [M_{eu} + M_{rw} * [d(p_{eu}/p_{rw}) / (p_{eu}/p_{rw})] * \sigma_{eu,rw}]$$

Where:

M_{rw} = imports from the rest of the world.

p_{eu} = price of the European Union.

p_{rw} = price of the rest of the world.

p_{eu}/p_{rw} = relative price of the European Union relative to the rest of the World.

$\sigma_{eu,rw}$ = elasticity of substitution between imports from the European Union and from other sources.

And,

$$p_{eu}/p_{rw} = [(1 + \tau_{eu1}) / (1 + \tau_{rw0})] / [(1 + \tau_{eu0}) / (1 + \tau_{rw0})] - 1$$

$$\sigma_{eu,rw} = [d(M_{eu}/M_{rw}) / (M_{eu}/M_{rw})] / [d(p_{eu}/p_{rw}) / p_{eu}/p_{rw}]; \sigma_{eu,rw} < 0.$$

where,

τ_{rw1} = tariff rate applied to imports from the rest of the world after tariff reduction

τ_{rw0} = tariff rate applied to imports from the rest of the world before tariff reduction

As formulated in Eq.(2) trade diversion is proportional to changes in relative prices, the imports from the European Union and the rest of the world and the elasticity of substitution. Trade diversion is higher the higher is: (i) the elasticity of substitution, (ii) the change in price and (iii) the imports from Europe and the rest of the world.

**Annex III:
The balance-of-payments constrained growth model**

In a nutshell, the model used can be summarized in four simple equations:

$$(1) X_a = \sum (P_a/P_b(1+\tau_i)^\theta Z_i^\varepsilon)$$

$$(2) M_a = \sum (P_b/P_a(1+\tau_a)^\psi Y_i^\xi)$$

$$(3) P_a \sum X_a = P_b \sum M_a$$

$$(4) y = (1/\sum S_i^{ma} Y_i^\xi) [(\theta_i \sum S_i^{xa} (t_i + (p_a - p_i)) + (1/\theta_i) Z_i^\varepsilon)] - [\psi_i \sum S_i^{ma} (t_i + (p_a - p_i))]$$

Where,

X_a = export volume of country a.

M_a = import volume of country a.

P_a = price of exportables of a.

P_i = price of imports from country i.

τ_i = ad valorem tariff imposed by A on outside imports.

τ_i = ad valorem tariff imposed by i on outside imports.

S_i^{ma} = share of imports in total imports of country A from country i.

S_i^{xa} = share of exports in total exports from country A to country i.

θ = price elasticity of the demand for the exports

ε = income elasticity of exports.

ξ = income elasticity of imports.

Lower case letters denote instantaneous rates of growth.

Equations 1 and 2 represent the export and import demand functions. Equation 3 states the condition for equilibrium in the balance of payments. Equation 4 gives the equilibrium rate of growth consistent with balance-of-payments equilibrium.

Annex V: ACP States in Africa and the effects of Cotonou

Of the 80 member States comprising the ACP countries, more than one half (48) are African countries. Given their level of development and their size, in geographical terms and in terms of population relative to the other ACP members, the Cotonou agreement and the implementation of Economic Partnership Agreements (EPAs) are of particularly relevance and concern to Africa.

As outlined above, implementation of the Cotonou agreement will essentially imply replacing current non-reciprocal trading preferences between Europe and ACP member States with reciprocal agreements to comply more closely with WTO rules on non-discriminatory trading arrangements. EPAs are to be concluded between the EU and ACP countries to dampen the effect of the erosion of current non-reciprocal trading preferences. As such, African countries share the same concerns vis-à-vis the Cotonou agreement as the other ACP members; these concerns relate to i) the effects of preference erosion on fiscal revenue; ii) whether the expected trade effects of the agreement will be due to trade creation or in fact trade diversion effects and iii) the welfare implications of preference erosion.

Regarding the fiscal impact of the Cotonou Agreement, data availability hampers quantitative analysis; however, various studies do indeed point to substantial declines in tariff revenue: figures of 24% for Namibia, 37% for Tanzania, 20-30% for Cameroon and approximately 25% for the Common Market of Eastern and Southern Africa (COMESA) have been noted as potential losses in trade taxes, Cape Verde could lose up to 80% of import revenues.⁵⁹ This is a significant amount for countries where trade taxes count on average for 25% of all government revenues and is of particular concern considering that low-income countries are only able to recover on average approximately 30% of lost trade tax revenue through other sources.⁶⁰

A recent study of the economic and welfare impacts of EPAs on Africa concluded that under full reciprocity, Sub-Saharan Africa's trade balance is likely to deteriorate by US\$1,868 million (1.3% of GDP) due to increased imports and decreased exports; overall, the welfare loss will exceed US\$500 million.⁶¹ Simultaneously, the European Union is likely to see an improvement in its terms of trade equivalent to US\$1,748 million (0.4% of GDP) due to expansion in its trade to Africa. Moreover, a significant part of this expansion is likely to result from trade diversion from the rest of the world as well as from within the EPA grouping itself; this diversion will particularly affect sectors that are characterized by a low degree of technology, primary sectors such as agriculture and the extracting industries and food-processing industries as these sectors will find it increasingly difficult to challenge the increased competition from abroad and are likely to falter in Africa. In fact, the majority of industries in Sub-Saharan Africa are likely to see a decrease in output under full reciprocity.

This impact on intra-African trade is particularly worrisome, especially as intra-African trade is already relatively shallow, reaching only approximately 10% of total exports from the

⁵⁹ See COMESA (2002), EUROSTEP (2004), Ndlela (2003) and Busse et al. (2004).

⁶⁰ See Tax Revenue and (or?) Trade Liberalization, IMF Working Paper 11, 2005.

⁶¹ See Economic and Welfare Impacts of the EU-Africa Economic Partnership agreements, United Nations Economic Commission for Africa, African Trade Policy Centre, 2005.

continent. Whilst one factor limiting the potential for intraregional trade is the fact that the majority of member States are primary commodity exporters, intraregional trade is hampered by weak competitiveness of African industries vis-à-vis industries elsewhere. Moreover, current trade arrangements governing the continent have not proven to be conducive to intraregional trade: in contrast to other ACP member States, African members have negotiated a number of trade agreements. Whilst this *per se* is a positive development, it has resulted in a situation where at present there are 14 ‘Regional Economic Communities’ (RECs) in Africa as well as numerous bilateral agreements on trade and investment.⁶² Such a plethora of agreements has consequently led to widespread confusion as to terms and conditions of trade relations between member states and is likely to have acted as a deterrent to trade. In fact, these multiple trading agreements have not succeeded in attracting foreign direct investment, increasing trade nor attaining higher economic growth within the continent: regional trade is hampered by the differing rules of origin and customs procedures of each of the RECs.⁶³

The negative impact of EPSs could be dampened if Africa were able to deepen its integration and increase intra-African trade as well as strengthen the competitiveness of its industries prior to concluding EPAs.⁶⁴ Thus, one of the main benefits of the Cotonou Agreement is its potential to act as an impetus to revisit and consequently rationalize the current setup of regional trading agreements within Africa. For one, multiple membership of RECs conflicts with the vision of several RECs to form custom unions and free trade areas. In addition, countries will need to decide which regional grouping to join for EPA negotiations as negotiations between the European Union and individual RECs will prove impossible with multiple memberships across RECs.⁶⁵

This impetus may however be one of the only benefits of the move to full reciprocity, as currently envisaged. To be able to benefit from the Cotonou agreement, African member States will need more time than currently foreseen to adequately prepare for the tariff dismantlement and strengthen their economies. Once this has taken place, the agreement could actually lead to total welfare *gains* equivalent to US\$1,200 million for Sub-Saharan Africa; these gains would reach more than US\$8,000 if in fact a free trade area between the European Union and Sub-Saharan Africa were created in which the partnership were not only WTO compliant (as currently foreseen), but in which *all* trade barriers between the partners were eliminated.

⁶² Overlapping membership in these RECs is widespread, with only 7 countries belonging exclusively to one REC, whilst 27 belong to 2 and one (Tanzania) is a member of 4 RECs.

⁶³ See World Investment Report 2002: Transnational Corporations and Export Competitiveness. UNCTAD, 2002

⁶⁴ See footnote 61.

⁶⁵ See The Cotonou Agreement and its Implications for the Regional Trade Agenda in Eastern and Southern Africa, World Bank Policy Research Paper 3090, 2003.