

GERMAN DEVELOPMENT INSTITUTE

**Negotiating Economic Partnership  
Agreements with the EU**

Opportunities, Risks, and Negotiation  
Options for Tanzania

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## **Preface**

The present study on Tanzania's preparations for negotiating an Economic Partnership Agreement (EPA) with the EU was carried out by a research team of the German Development Institute (GDI) within the framework of the GDI's 2002/2003 postgraduate training course. The report's aim is to contribute to the preparations of EPA negotiations in ACP countries by providing information and structured guidance on the main dimensions of EPAs, on their potential impact, and on the negotiation opportunities that arise. Comprehensive fieldwork was carried out in Tanzania between February and April 2003. The research team closely co-operated with the Tanzanian Office of the President, the Commission on Planning and Privatisation (POPP), and the Economic and Social Research Foundation (ESRF) based in Dar es Salaam.

When the field research was being conducted, the geographic configuration of EPAs at the regional level was not yet clear. In November 2003, member countries of the various regional organisations in Eastern and Southern Africa formally announced the configuration under which they were going to negotiate a regional EPA. In the case of Tanzania, which is a member of both the East African Community (EAC) and the Southern African Development Community (SADC), a decision was made in favour of SADC. Some of the analysis of the present study concerning the regional level was done on the assumption that Tanzania would negotiate as part of EAC. The considerations and recommendations presented by this report, however, still apply, as the case of EAC served to exemplify the more general difficulties and the complexities that arise from negotiating as a regional entity. We therefore think that the main findings are useful all the same, for Tanzania as well as for other countries, particularly LDCs, in the region.

We would like to express our gratitude to all our interview partners in the United Republic of Tanzania, in Germany, Brussels, and Maastricht for their interest, time and patience, as well as for sharing with us their valuable information, knowledge and experience. Special thanks go to the participants of two workshops held in Dar es Salaam in April 2003, where our preliminary findings were discussed with representatives from ministries, parliament, civil society organisations, the private sector, donor agencies, the research community and non-governmental organisations. We are mostly indebted, however, to our counterparts, Ms. Diana Makule from POPP, and Dr. Josaphat Kweka of ESRF for their competent advice and their support. Special thanks also go to Dr. Michael Stahl from GTZ and the staff of the East African Community's Secretariat in Arusha for their cooperation. The views expressed in the present report, as well as any shortcomings that may remain, are of course entirely our responsibility.

*Asante sana!*

Bonn and Gaborone, November 2003

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## List of Abbreviations

ACP	Group of African, Caribbean and Pacific States
AfDB	African Development Bank
AGOA	African Growth and Opportunities Act
CAP	Common Agricultural Policy
CET	Common External Tariff
cif	Cost, Insurance, Freight
COA	Committee of Ambassadors
COMESA	Common Market for Eastern and Southern Africa
CTI	Confederation of Tanzania Industries
DANIDA	Danish International Development Agency
DC	Developing Country
DFID	Department for International Development
DG	Directorate General at the European Commission
EAC	East African Community
EALA	East African Legislative Assembly
EBA	Everything-But-Arms Initiative
EC	European Commission
ECDPM	European Centre for Development Policy Management
ECOWAS	Economic Community of West African States
EDF	European Development Fund
EPA	Economic Partnership Agreement
EPZ	Export Processing Zone
ESRF	Economic and Social Research Foundation
EU	European Union
FDI	Foreign Direct Investment
FTA	Free Trade Area
FTAA	Free Trade Area of the Americas
GATT	General Agreement on Tariffs and Trade
GDI	German Development Institute
GDP	Gross Domestic Product
GSP	Generalised System of Preferences
GTZ	Deutsche Gesellschaft für Technische Zusammenarbeit
HS	Harmonised Commodity Description and Coding System
IGAD	Inter-Governmental Authority for Government
IOC	Indian Ocean Commission
IRCC	Inter-Regional Co-ordination Committee
ITC	International Trade Centre
JITAP	Joint Integrated Technical Assistance Programme



LDC	Least Developed Country
MAFS	Ministry of Agriculture and Food Security
MDV	Minimum Dutiable Value
MERCOSUR	Mercado Común del Sur
MFAIC	Ministry of Foreign Affairs and International Co-operation
MFN	Most Favoured Nation
MIT	Ministry of Industry and Trade
MOF	Ministry of Finance
NGO	Non-Governmental Organisation
NIP	National Indicative Programme
NSA	Non-State Actor
NTB	Non-Tariff Barrier to Trade
OECD	Organisation for Economic Co-operation and Development
PMU	Project Management Unit
POPP	President's Office Planning and Privatisation Commission
PRS	Poverty Reduction Strategy
RCA	Revealed Comparative Advantage
RI	Regional Initiative
RIP	Regional Indicative Programme
RoO	Rules of Origin
SACU	Southern African Customs Union
SADC	Southern African Development Community
SDT	Special and Differential Treatment
SPS	Sanitary and Phytosanitary Standards
TANGO	Tanzania Association of Non-Governmental Organisations
TCAL	Tanzania Chamber of Agriculture and Livestock
TCCIA	Tanzania Chamber of Commerce, Industry, and Agriculture
TDCA	Trade, Development and Co-operation Agreement
TEDET	Tanzania Eco-Development Trust
TGNP	Tanzania Gender Network Programme
TIC	Tanzania Investment Centre
TRA	Tanzania Revenue Authority
TSh	Tanzanian Shilling
TTPP	Tanzania Trade and Poverty Programme
TUCTA	Trade Unions Congress of Tanzania
UNCTAD	United Nations Conference on Trade and Development
VAT	Value Added Tax
VIBINDO	Viwanda na Biashara Ndogondogo (Small Business Association)
WTO	World Trade Organization



## Summary of Findings and Recommendations

### Background and Rationale of the Study

In September 2002, negotiations on Economic Partnership Agreements (EPAs) formally started between the European Union (EU) and the group of the African, Caribbean and Pacific (ACP) countries. EPAs are an integral part of the Cotonou Agreement, which was concluded between the parties in 2000 and is the successor of the Lomé Conventions. The Cotonou agreement aims at defining a new development partnership between the EU and the ACP countries, including a comprehensive overhaul of the current trade arrangement, which has been characterised by unilateral trade preferences extended to the ACP countries by the EU.

The aim of EPAs is to introduce, for the first time in the history of the special relations between the EU and the ACP countries, reciprocal free trade, preferably as Free Trade Areas between the EU and ACP sub-regions. The underlying motives are on the one hand the need to make ACP-EU trade relations compatible with the World Trade Organisation's (WTO) rules and regulations; on the other hand, the underlying assumption of the EPA concept is that trade liberalisation and regional trade integration will enhance the ACP countries' competitiveness and accelerate their integration into global markets. EPAs are to be negotiated over a period of four years, or by the end of 2007, when the current WTO waiver expires and the new agreement needs to come into force.

The present study analyses the risks and opportunities entailed by the planned Economic Partnership Agreements. With special reference to the United Republic of Tanzania, this report identifies the potential fiscal, economic and social effects of EPAs and analyses the institutional set-up for EPA negotiations at the all-ACP, regional and national level. It assesses the capacity for strategic trade policy formulation and the degree of preparedness for EPA negotiations at both the national and the regional level. Finally, the study gives a number of recommendations regarding the eventual scope and con-

tent of EPAs, and identifies necessary steps for the preparation of the negotiations.

It is obvious that EPA negotiations are both a great challenge and an opportunity for ACP countries, in particular for the large number of Least Developed Countries (LDCs) among them, of which Tanzania is one. The aim of this report is to point out these challenges. In spite of some quantification carried out on the fiscal impact of EPAs, the present study is deliberately non-technical and focuses on the major risks and opportunities, including those relating to negotiation skills and institutional mechanisms that must be created at the national, regional and multilateral level. More detailed impact studies and economic analyses at the sectoral level and on some technical issues will have to be carried out during the course of the negotiations.

### EPAs in the Context of other Preferential Trade Arrangements and the WTO

The EPA negotiations will introduce a number of important changes to the traditional trade relationship between the EU and the ACP countries. While the declared aim is to ensure that the achievements of the Lomé Conventions – the so-called Lomé acquis – are maintained, it is also clear that the new trade arrangement needs to change considerably to become WTO-compatible. The current trade regime is based on unilateral preferences given by the EU to the ACP and could as such be challenged as unfair by other developing countries. The regime is only functional because of a waiver which was extended by the WTO but which expires at the end of 2007. Hence the time pressure for a new agreement.

The alternative offered by the EPA concept lies in reciprocal free trade agreements (FTAs) between the EU and regional sub-groupings of the ACP, where the ACP would gradually liberalise trade vis-à-vis the EU. This would enable the EU to maintain the current preferential market access for the ACP, which is better than the preferences given to other developing countries under the EU's General System of Preferences (GSP). Matters are complicated further, however, by the fact that the LDCs in the group already enjoy non-reciprocal duty and quota-

free access to the EU under the Everything-But-Arms Initiative (EBA). As this regime defines preferential access for all LDCs regardless of geography or history, it is considered compatible with WTO principles.

One of the main problems that arise with EPA negotiations is therefore that the interests of the ACP countries vary according to their status as LDCs and non-LDCs. If mixed groups are to negotiate a single agreement, as is already foreseeable, these interests have to be harmonised. For both country groups the basic negotiation strategy is to keep their current preferences and achieve non-tariff improvements of market access in return for concessions on reciprocal trade liberalisation. The second major difficulty is due to the fact that the actual value of preferences and the scope of concessions required for WTO compatibility are not yet clear and will be influenced by the outcome of negotiations under the WTO's Doha Development Agenda expected to be finalised only by 2006.

### **Fiscal, Economic and Social Impact of an EPA**

The present analysis points out that the fiscal impact of an EPA, resulting from a combined effect of the tariff reduction on revenue and changes in the trade pattern, is substantial but less dramatic than has been argued in previous studies in the case of Tanzania. What appears more problematic is the fact that whatever the revenue loss, Tanzania has little scope to compensate for it by increasing its already high VAT rate any further. On the contrary, because of the pressure arising for Tanzanian producers from increasing competition from within the region and abroad, there is even an ongoing discussion on lowering the VAT rate. Unavoidable tariff losses will then have to be compensated for through other revenue increases or expenditure cuts, but this may likewise run up against political resistance.

According to our findings, trade liberalisation will have a negative impact on a number of private businesses that produce final goods and currently enjoy high levels of protection. Some will be able to make use of the envisaged transition periods for the nec-

essary adjustments in quality and productivity, particularly in those industries benefiting from comparative advantages such as the agro-processing industries. However, the benefits from cheaper imported inputs will not be substantial, as the EU is not the lowest cost producer for most Tanzanian inputs. Within the manufacturing sector, textiles and clothing, and to a lesser extent auto parts, are shown by our findings to be among the most sensitive industries in the case of opening up for duty free trade with the EU.

Of special concern for Tanzania, as for the majority of ACP countries, is the potential impact of EPAs on the agricultural sector. This sector contributes a large share to GDP and employs most of the poor. Our analysis shows on the one hand that the agricultural sector appears to be in a better position with respect to increasing EU competition than manufacturing. Tariff elimination, according to our findings, will not lead to a sudden surge in agricultural imports from the EU. This result is, however, subject to some qualifications. If prices of EU exports rapidly decrease (due to Eastern European enlargement for instance), or if the level of domestic or export subsidies further increases for certain products (e.g. because of a reshuffling under the EU's Common Agricultural Policy), the picture may change substantially. Precautions should be taken to avoid any further unfair competition for the agricultural sector under EPAs.

On the export side, concluding an EPA will not result in additional export opportunities for producers in Tanzania or elsewhere in the ACP countries, unless they are accompanied by substantial reforms of the EU's price-distorting agricultural policies, and by targeted measures in the ACP countries to help them comply with the EU's sanitary and phytosanitary requirements. In Tanzania the agricultural sector faces a number of internal deficiencies that heavily constrain its ability to benefit from new export opportunities particularly in non-traditional agricultural goods. As long as the agricultural sector is not in a position to benefit from trade, the overall development-related impact of EPAs will be minimal.

More generally speaking, our analysis shows that if the objective of poverty reduction is to be achieved

within the framework of the Cotonou Agreement, it will be essential to define complementary measures and flanking policies to trade in a way that more directly benefits the poor. The EPA concept itself says nothing on this point, and the European Commission has thus far been reluctant to establish any closer link between the EPAs' trade component and their development dimension. The EC has also rejected the idea of "additional funds" for EPAs beyond the resources earmarked for capacity building activities. The present analysis shows, however, that there will be extra-needs associated with adjustment costs and revenue losses that should at least in part be addressed by the resource allocation processes under the EU's National Indicative Plans (NIPs), while the Regional Indicative Plans (RIPs) may help to cater to unequally distributed costs and benefits of EPAs in the sub-regions.

### **State of Preparedness and Institutional Arrangements at the National and Multi-lateral Level**

The possibility to negotiate an EPA is an important opportunity in itself, as it gives the ACP countries the chance to influence the eventual outcome, thereby maximising their benefits and mitigating their risks. The prerequisite is, however, that the ACP countries are in fact in a position to negotiate strategically, i.e. to analyse, formulate and proactively pursue their positions during the negotiations. The analytical and institutional capacity needed for this is very limited in most ACP countries. Trade policy formulation is a challenging task as it affects a number of areas of an economy. Consequently, this will involve inputs from various stakeholders, including several ministries as well as the private sector and intermediate institutions and organisations. For EPA negotiations, a national trade policy needs to be coordinated at the regional level and with delegations in Brussels and, potentially, Geneva.

Our findings indicate that in the case of Tanzania the preparation process for EPAs has not advanced very far and has been characterized by a fragmentation of responsibilities and mandates. The Ministry of Industry and Trade has only very recently been

named to lead the process, but the resources it has to comply with that responsibility are severely limited. This is partly due to the fact that traditionally trade issues have not been high on the agenda of policy makers and of most other stakeholders, including the donor community in Tanzania. The fact that Tanzania's Poverty Reduction Strategy (PRS) of 2000 does not mention trade as one of the focal areas for strategic action is revealing.

The uncertainty about the specific parameters of EPAs, and a widespread perception that EPAs will mainly serve the interests of the EU, have added to the passive or even reluctant attitude found at all levels in Tanzania concerning the preparation of EPA negotiations. As a result, the Government's capacity, but also its political resolve, to prepare for EPA negotiations have been limited, and the preparation process is still in an early stage. This is particularly worrisome in view of the immediate need to enter into phase II of the negotiations that are set to be conducted at the regional level, which, however, will necessarily have to be based on national preparations.

### **Involvement of Non-State Actors**

Involvement of non-state actors (NSAs) in EPA negotiations is one objective of the Cotonou Agreement, of which the EPA concept is part. Most ACP governments have difficulties putting this objective into practice for lack of experience, capacity, funding and political will, or a combination of all these factors. Evidence from the Tanzanian case shows that the Government's capacity to deal with EPA negotiations is very limited and that no initiatives have been taken so far to inform NSAs about the EPA process or to define how they are to be involved in the preparations. The most systematic effort in terms of awareness raising on Cotonou and EPAs made so far has been undertaken by the German Friedrich Ebert Foundation, but even this has not met with keen interest from governments in most countries, including Tanzania.

From the side of the European Commission there has been little guidance on how to involve NSAs. Moreover, neither incentives nor sanctions are pro-

vided for in the case of (non-)involvement of NSAs. While there have been sporadic efforts in the context of designing National Indicative Programmes since 2000, the outcome has been limited in both coverage and scope, and it has not resulted in a systematic NSA involvement in defining EU-ACP cooperation policies at the national level. Given the complexity of trade negotiations, more targeted action will be needed to identify, capacitate and involve the relevant NSA representatives in the EPA preparations.

### **Regional Dimension of EPA Preparations**

Regional integration initiatives (RIs) are to be the building blocks of EPAs, and ongoing integration processes will be further enhanced by EPAs. However, at the time of writing, the geographic configuration for phase II EPA negotiations was still unclear. Overlapping memberships between the existing regional initiatives add to the difficulty of clarifying configuration and mandate. The regional secretariats, one potential structure to co-ordinate EPA negotiations, currently lack both the mandate and the capacity required. The overlap problem is not the fault of EPAs – in fact, EPAs will increase the pressure in favour of a rationalization of memberships and regional commitments of countries. But one should take into account that EPAs create unnecessary time pressure for the existing RIs and that they introduce different objectives into the regional integration agenda. This may well run counter to a deepening of integration processes.

Even once the question of configuration is resolved, the assignment of responsibilities between the regional and the national level will not prove easy to clarify. The process of deeper regional integration involving institution building and transfer of sovereignty to the regional level has only just begun in the ACP regions, and EAC and SADC are no exceptions in this respect. The EPA concept does not take into account the reality of regional integration processes and the capacity of the existing RIs in most of the ACP sub-regions. As a minimum, the regional groupings will have to create regional EPA task forces or negotiation teams appointed by member

states to coordinate the negotiations at the regional, i.e. the supra-national level.

### **Recommendations**

The Cotonou Agreement puts forward the idea of a partnership on an equal footing, and engaging in EPA negotiations will be a real test for the new quality of this partnership. On the one hand, this requires that the ACP side urgently address the capacity constraints relating to trade policy issues at the national and regional level. On the other hand, the EU will have to demonstrate that with EPAs it is pursuing genuinely development-related rather than purely strategic or commercial interests.

One of the greatest opportunities – i.e. that the outcome of EPAs is at least to a certain extent negotiable and not unilaterally determined – is therefore at the same time the greatest risk. The unequal bargaining power of the negotiating parties is more than obvious, with the European Commission and its clear mandate and negotiation experience on the one side and the ACP group, soon to be sub-divided into yet unclear regional groupings, on the other. The present analysis confirms moreover that the bargaining power of the ACP countries will be restricted because of a lack of analytical and negotiation capacity, but also by the lack of political resolve to prepare for and formulate strategic positions for the negotiations.

EPAs will be negotiated and it is therefore essential for all ACP countries to clearly identify the risks and opportunities involved and to weigh the costs against the benefits throughout the negotiations. The need to define and co-ordinate negotiation positions at the regional level has to be tackled urgently. Although this poses a major challenge to the RIs currently involved in the deepening of regional integration processes as described above, it will also force the sub-regions to bundle their resources and to assume an active part in multilateral trade negotiations for the first time.

The recommendations can be summarized as follows.

At the national level, Tanzania and most other ACP countries need

- to commission thorough impact studies to reduce uncertainty concerning the potential benefits and losses of an EPA;
- to set up a national task force to co-ordinate EPA preparations of negotiations to overcome the fragmentation of responsibilities in the field of trade policy formulation and to establish a focal point for all relevant stakeholders, such as the private sector and civil society.

At the regional level, countries will have

- to urgently decide on the geographical configuration of EPAs and to define roles and mandates for the preparation of the negotiations between national and regional authorities;
- to actively tackle the problems arising from overlapping memberships, including setting up mechanisms to harmonise negotiation positions between those RIs that overlap;
- to harmonise negotiation positions and strategic interests within the groupings and particularly between LDCs and non-LDCs in each group.

At the multilateral level, Tanzania together with its regional partners should negotiate for:

- an outcome as close as possible to the EBA scheme in terms of a total abolition of all tariffs and quotas on ACP exports;
- the elimination of NTBs and targeted supply side assistance to reduce export constraints;
- the definition of appropriate safeguards, especially in the agricultural sector;
- special and differential treatment for LDCs, especially if they negotiate a joint EPA with non-LDCs;
- compensatory measures in return for concessions made in the area of reciprocal trade liber-

alisation to take into account adjustment costs and revenue losses.

In addition to these negotiable positions, it needs to be clear that the ACP themselves have to undertake a number of steps towards necessary domestic reforms if EPAs are to be beneficial for them. More than anything, national governments will have to ensure that trade policy is better aligned with the relevant national policies, in particular fiscal reforms and agricultural policy, and that it is embedded in a poverty reduction strategy, as this is a precondition to make efficient use of trade and permit it to contribute to pro-poor growth.

Another very relevant step to ensure a beneficial outcome of EPAs is without doubt the reform of the EU's Common Agricultural Policy (CAP). While this reform is negotiated in other forums – within the EU and at the level of the WTO – during EPA negotiations, any opening up of agricultural sectors on the side of the ACP countries could be made conditional on substantial changes regarding the use of subsidies in the EU.

Finally, over and above the eventual agreements themselves, ample assistance from the donor community should be made available to build trade capacity and to enable the ACP countries to be equal partners in global trade. Naturally, as the negotiating partner, the EU cannot directly assist the ACP countries in determining their negotiating positions. Nevertheless, the EU, and in particular the EU country delegations, can help raise awareness by disseminating information, especially about available funds and programmes for trade capacity building. Programmes of other international cooperation partners who have expertise to offer will have to complement these efforts in the area of trade and private sector promotion, such as UNCTAD, the WTO and some bilaterals like DFID, DANIDA or GTZ.

In order to make EPAs an effective instrument for the integration of ACP countries into the world economy and at the same time to make them consistent with the overarching objectives of poverty reduction and sustainable development, we suggest that the European Commission should

- show flexibility regarding timeframes and give regional groupings time to pursue and deepen ongoing regional integration processes;
- cater to the needs of the LDCs through special and differential treatment regardless of configuration;
- offer improved market access in terms of a dismantling of NTBs in return for trade liberalisation of the ACP;
- ensure that applications for funding and trade capacity building are processed in an efficient and timely way;
- make the EU country delegations explicitly responsible for dissemination of information about EPAs as well as for awareness raising among the various stakeholders about potential implications of EPAs;
- foster and insist on the involvement of NSAs in trade policy formulation, as this was seen as one of the fundamental principles when the Cotonou Agreement was signed.

Further, we suggest that the donor community, especially the EU member states, should

- assist in trade capacity building, particularly in countries like Tanzania, where trade issues have not been high on the agenda;
- closely co-ordinate trade capacity building efforts to avoid fragmentation of various projects and programmes by different donors and to increase effectiveness;
- make EPA capacity building an element of already existing trade capacity building structures instead of establishing new ones;
- ensure that trade capacity building programmes take into account overarching national strategies and poverty reduction programmes and closely align trade and other sectoral policies with them.

The challenges ahead are numerous. To tackle them will demand political commitment and additional resources on the side of the ACP countries and their international co-operation partners, particularly the EU. Without a clear conviction on all sides that EPAs will be a success and benefit farmers, industries and society at large, there will be little support by ACP policy makers when it comes to implementation of the agreement.



## 1 Introduction

In June 2000 the EU and the group of African, Caribbean and Pacific states (ACP) signed the Cotonou Agreement in the capital of Benin. The Agreement replaced the Lomé Conventions that had shaped the special relations between the EU and its former colonies since 1975. With respect to trade and economic co-operation, the Cotonou Agreement provides for separate negotiations of Economic Partnership Agreements (EPAs) between the signatories. According to the Cotonou Agreement, the primary objective of EPAs is to foster the "smooth and gradual integration of the ACP States into the world economy" (Article 34.1). In pursuance of this goal, EPAs are to provide for reciprocal free trade areas between the EU and the ACP that conform to the rules and regulations of the international trade framework, i.e. that are WTO-compatible. In coherence with the overall objectives and principles of the Cotonou Agreement, EPAs are moreover intended to contribute to poverty reduction and sustainable development in the ACP states. Finally, EPAs are envisaged to build on existing regional integration initiatives among the ACP and thereby foster regional trade integration processes.

In September 2002 negotiations on the future EPAs formally started in Brussels at an all-ACP level. The two parties agreed that from September 2003 on a second phase of negotiations would be entered into, when the details of EPAs would be negotiated with regional groupings of ACP countries. The new agreement is set to be concluded by the end of 2007 at the latest, and in 2008 implementation will commence. The transition period to the full implementation of free trade areas is planned to be completed by 2020.

### Background and Rationale for EPAs

Following from the Cotonou Agreement, EPAs will eventually replace the Lomé Conventions and redefine trade relations between the EU and the ACP. The EC has stressed in various communications that, in contrast to Lomé, it is willing to negotiate and implement EPAs at a regional rather than at an all-ACP level. For the first time the element of re-

ciprocity will be introduced to trade relations between the signatories. The ACP side has in principle accepted that changes to the old regime have become unavoidable and that the benefits of current unilateral preferences have been of limited value for the majority of ACP countries. With a view to reciprocity the group has stressed, however, the need to take into due account their lower stage of development and to provide maximum flexibility in EPA negotiations to accommodate to their particular needs. The ACP have moreover emphasised their interest in maintaining ACP unity and solidarity throughout negotiations. According to the Cotonou Agreement, the eventual geographical configuration of EPAs is up to the decision of the ACP, including the choice to negotiate individual EPAs at the country level.

For the EC one important motivation to negotiate EPAs can be found in the more general objective to restructure and rationalise its trade agreements with its main groups of trading partners. While WTO conformity is one element of the approach, regionalism and the negotiation of preferential bilateral agreements with a number of strategically important trade partners have become additional important pillars of the strategy. From a political economy point of view, the EU's readiness to assist the ACP in their accession to world markets is clearly linked to the objective of maintaining and further strengthening traditional spheres of influence in the developing world. According to communications by the European Commission (EC), it is ready, however, to offer assistance within the EPA framework to ACP countries in all trade-related areas, and to promote regional integration initiatives among them. So far, however, the EC has not proposed any concrete improvements over the current arrangements, particularly concerning markets access. The ACP have for instance requested further reductions of tariff escalation in EU markets, the dismantling of non-tariff barriers to trade and a substantial lowering of trade-distorting subsidies in agriculture in return for preference erosion.

For the ACP group, it is not easy to strike a balance between the potential costs and benefits of the new agreement. While nobody would deny the numerous deficits of the Lomé regime, some ACP countries

have clearly benefited from its preferences, in particular from those that granted market access at above-market prices via the various commodity protocols. Another important concern of ACP countries is the potential impact of reciprocal free trade on their revenue from tariffs. Moreover, reciprocity will affect domestic markets through increased competition from EU producers. Depending on the coverage and sequencing of trade liberalisation, trade dynamics, the availability of alternative sources of fiscal revenue, and above all the responsiveness of the private sector and its ability to overcome current supply-side constraints, ACP economies will therefore incur higher or lower adjustment costs – or reap additional benefits from the new arrangement.

One key concern that arises with a view to the upcoming negotiations is whether ACP countries will be able to make use of the new partnership approach as it is envisaged in the Cotonou Agreement. The intention to institute dialogue and negotiations to achieve a mutually binding agreement between trade partners – rather than continue with unilateral preferences granted by the EU, as under the Lomé Conventions or the Everything-But-Arms Initiative (EBA) – has been well received. However, the eventual outcome of EPAs will depend on the capacity of ACP countries to identify, formulate and effectively negotiate their strategic interests vis-à-vis the EU. It is quite clear that the signatories to the Cotonou Agreement differ widely in their economic weight and their trade negotiation capacity, and consequently they have very different levels of bargaining power. Hence, trade capacity building will be one of the most urgent issues to deal with alongside negotiations.

With a view to phase II of the negotiations, the opportunities and risks embodied in the EPA concept require detailed analysis. ACP countries and regional organisations need to be fully aware of their negotiation options, and of the potential risks and opportunities involved. Prior to ratification of EPAs, ACP countries will need to be informed of all obligations arising from the agreements, as well as of their respective social, economic and political implications. This refers to both the country and the regional level.

According to the EPA concept, the agreements should strengthen regional integrations processes. But existing regional organisations in Africa so far lack the mandate of their member states and also the capacity to take the lead in trade negotiations with third countries. Overlapping memberships, varying speeds of integration processes and the heterogeneity of member states in terms of level of development and economic structure are bound to render the negotiation of EPAs at the regional level an extremely complex process, and there is an inherent risk of overstressing the capacities of the regional organisations both technically and politically. As EPAs are explicitly to support ongoing regional integration processes, and existing regional groupings are seen as building blocks of the new trade arrangement, there appears to be an urgent need to strengthen negotiation and implementation capacity at the regional level and to factor in these ‘new players’ during the negotiations.

Finally, it is important to note that the eventual outcome of a number of other ongoing negotiation processes may directly affect EU-ACP trade relations and the shape of EPAs. Among the most important issues are those arising from the Doha round of multilateral trade negotiations and the WTO framework in general, in particular any changes pertaining to Article XXIV of the GATT on free trade arrangements between developing and developed countries and provisions for special and differential treatment of the Least Developed Countries (LDCs). Moreover, the process of EU enlargement and potential reforms to the EC’s Common Agricultural Policy (CAP) are of special concern for EPA negotiations.

## **Objectives of the Study**

The main objective of the present report is to contribute to the preparations of phase II negotiations in Tanzania and to provide key stakeholders in Tanzania with substantiated information on the potential risks, opportunities and negotiation options involved with EPAs.

More specifically, the present report seeks:

- To inform stakeholders on the provisions as stated in the Cotonou Agreement regarding the EPA concept, the changes envisaged as compared to the Lomé framework, on related trade regimes currently in place such as the EBA initiative of the EU, and on the general trade regulations given by the WTO framework, as these are perceived to be the main reference points for EPA negotiations;
- to identify against this background the opportunities and risks entailed in the EPA concept for the case of Tanzania, generalising these findings where possible to a more comprehensive ACP perspective;
- to analyse at the country level the ongoing preparations for EPA negotiations with a particular view to the institutional set-up and the involvement of non-state actors, including the private sector, in the preparations for negotiations;
- to assess the state of regional integration for the case of the EAC as one potential configuration for an EPA, and to identify the risks and opportunities involved in EPAs for the regional integration process; and finally
- to formulate recommendations regarding the process of strategy formulation as well as on measures to be taken to strengthen trade capacity at the national and regional levels, including the potential role of donor support.

When the present report was finalised, the potential implications of an EPA had not yet been assessed systematically from the country perspective. While the EU commissioned a number of regional impact studies in the late 1990s, including a study on the EAC, their findings offered merely a starting point for the discussion, and they are now outdated in several respects. More recently, a regional impact study was produced for SADC on behalf of the ACP and SADC Secretariat (Trades Centre 2003). Based on partial equilibrium analysis using the SMART methodology developed by UNCTAD, the authors

find that EPAs will result in substantial revenue losses, entail significant adjustment costs and potentially undermine regional integration processes. The authors recommend tying the phasing in of trade liberalisation to certain thresholds of development indicators.

By the end of 2002, terms of reference for country studies had been issued by the ACP Secretariat, but a number of countries were late in commissioning these studies. As for the case of Tanzania, the Government submitted its terms of reference and applied for the respective funds in Brussels in April 2003, and the drafting process was still underway at the time of writing.

In addition to being delayed, an important deficit of the current preparations may evolve from the fact that the discussions so far have concentrated on the economic implications whereas problems relating to the overall development impact of EPAs, their political dimension and the institutional structure of negotiations have not yet been addressed. Questions relating to the role of the existing regional bodies have not been tackled, and none of the negotiation parties has suggested yet how non-state actors should be involved in the preparation of negotiations. Finally, while there is broad consensus on the fact that ACP countries generally lack trade negotiation capacity, so far very few concrete measures have been undertaken to actually build up this capacity.

It should be noted that the present report does not seek to substitute for the national Tanzanian process of preparation for negotiations, nor does it aim to render obsolete other impact studies carried out at the national or regional level. Rather, the present study seeks to complement such analyses by shedding light on the political economy of EPA negotiations. The strategy building processes at the national and regional levels are entirely up to the local stakeholders. Hence, our main contribution lies in the stimulation of discussions among these stakeholders.

The present report is structured as follows. Chapter 2 discusses the methodological approach and timetable of the study. Chapter 3 outlines the principles

and objectives of the Cotonou Agreement and assesses the main changes introduced by the EPA concept compared with the former Lomé Conventions. We also explain the major elements of the EPA concept and discuss alternative options for EPA negotiations against the background of relevant multilateral trade regulations. Chapter 4 outlines the fiscal and economic impact of EPAs by means of a comparative static analysis and delineates the potential social implications for Tanzania. Chapter 5 gives an outline of the current state of EPA negotiations in Tanzania and identifies the main shortcomings of national trade policy formulation. Furthermore, the chapter puts special emphasis on the role of NSAs in the EPA preparation process. Chapter 6 analyses the potential opportunities and risks for regional initiatives in the context of EPAs, paying particular attention to the state of EPA preparations in the EAC. The final chapter provides a summary of the main findings and a general assessment of the EPA concept. The report concludes with recommendations for the negotiation parties and the donor community on how to make EPAs an effective instrument for the development of ACP countries.

## 2 Methodological Approach

The present study was carried out in two phases. During the first phase, from November 2002 to mid-February 2003, the research team conducted a desk study. The team reviewed the relevant literature and official documents on the Cotonou Agreement, critically analysed the EPA concept and the state of negotiations, and assessed the socio-economic situation of Tanzania and the country's state of integration into world and regional markets.

The second phase was comprised of a field study in Tanzania and was carried out between mid-February and the end of April 2003. During this phase, the research team collected trade and revenue data and carried out interviews with key stakeholders from the public and private sectors as well as with civil society. Throughout the field phase the research team assessed information gaps and disseminated

missing information on the Cotonou Agreement and EPAs to stakeholders. The research team analysed the data collected and presented preliminary findings at two workshops held in Dar es Salaam. The results of the workshop discussions were integrated in the present final report.

**Collection of empirical data:** In order to assess risks and opportunities of EPAs and to identify the main negotiation options, we chose a combined approach consisting of qualitative and quantitative data collection and analysis. The qualitative approach was used to gather data on the current state of the regional integration process and to assess the role of trade policy and the past and present involvement of the various stakeholders in its formulation. The relevant stakeholders include government representatives from Tanzanian ministries from both mainland and Zanzibar, staff of the East African Community Secretariat, various para-statal and academic institutions, business representatives, as well as a number of NGOs (see Annex A and Table 1, below). The majority of interviews were conducted in Dar es Salaam, where most of our interview partners from the public and private sector and most civil society organisations are based. The data was supplemented by interviews conducted in Arusha region, where the EAC Secretariat is based but which is also one of the country's major commercial and agricultural regions. The team conducted interviews with entrepreneurs of the manufacturing and agricultural sectors in the Dar es Salaam and the Arusha/ Kilimanjaro region. To take into account the special situation of Zanzibar within the United Republic of Tanzania, the researchers also interviewed officials of the Zanzibarian Government.

The interviews sought to explore the interviewees' perceptions and positions towards EPAs, aiming to identify, from different angles, the risks and opportunities for Tanzania associated with the creation of EPAs. All interviews were based on semi-structured questionnaires (see Annex B). The questionnaires took into account the heterogeneity and varying levels of information of the stakeholders interviewed and were slightly adapted where necessary. Interviews were in most cases conducted by two researchers. Further official and internal documents

**Table 1: Distribution of Interview Partners**

	Associations etc. <sup>1</sup>	Donor Community	EAC Secretariat	Government	NGOs	Private Sector	Research Community	Total
Number of Interviews	12	9	7	18	5	19	10	80

gathered from interview partners were used to complement the qualitative data collected.

In addition, the team worked with quantitative data from various sources such as the Bank of Tanzania and the Tanzania Revenue Authority, mainly on trade and revenue collection. The data served to compute the implications of trade liberalisation on revenue collection, trade performance and main economic sectors.<sup>2</sup>

**Capacity building:** A second aim of the project's field phase was capacity building, i.e. provision of stakeholders with information on EPAs, the current state of negotiations, and, more generally, on negotiation options. In accordance with the main intention of the present project – that is, to contribute to the preparation of EPA negotiations, to stimulate discussions and build capacity in this respect – the methodological approach differed somewhat from purely research-led studies.

These objectives were pursued by three means: First, by distributing information on EPAs, discussing sensitive issues and thereby raising awareness on the topic among stakeholders. Second, the team compiled an EPA information package and distributed it to stakeholders.<sup>3</sup> Third, the research team

conducted two workshops with the main stakeholders involved, thereby complementing and enhancing ongoing research and capacity building processes on the implications of the Cotonou Agreement, of trade liberalisation and of regional integration efforts on Tanzania.<sup>4</sup> The workshops also addressed the role of the donor community and its potential contribution to trade capacity building and preparations for EPA negotiations in Tanzania.

Although the present study was conducted on schedule and is quite comprehensive in scope, it suffers from a number of limitations. First, and perhaps most importantly, it should be noted that throughout the interview phase the study team had to cope with the fact that for most stakeholders EPAs still appear to be a largely hypothetical scenario that is not a priority on their agenda. Often, the concept of EPAs even meets with open disapproval and is seen as something negative imposed from the outside. This is obviously a limitation involved in the stakeholder approach chosen by the research team, one which was particularly virulent in the interviews conducted with representatives from civil society organisations.

Secondly, a full assessment of the economic implications of EPAs on individual economic sectors would have required a deeper analysis of the current situation at the industry and enterprise level than was possible within the scope of the present multidisciplinary study. The empirical data collected are therefore rather a snapshot, though one highlighting the main risks and opportunities involved in EPAs for the most relevant sectors.

1 These include business development services, chambers, trade unions associations, investment centres, etc.

2 Details on the methodology used in this part are contained in Annex D.

3 The package consisted of relevant information suitable to get acquainted with the subject as well as with the opportunities and risks of EPAs and the ways in which various stakeholders are involved. Apart from documents on EPAs and the Cotonou Agreement and the Agreement itself, we included parts of the Cotonou Infokit compiled by ECDPM.

4 The workshops were carried out in close cooperation with the Friedrich Ebert Foundation and ESRF, which are among the institutions most actively engaged in research and capacity building in the respective fields.

Thirdly, at the time of writing the geographic configuration for EPAs was still unclear. The present report analyses the East African Community (EAC), of which Tanzania is a member, in more detail so as to highlight some of the implications of the EPA negotiations at the regional level. An in-depth impact study on the fiscal and economic implications of an EPA with a certain configuration can, however, only be conducted when the configuration has been decided on. Moreover, the present report does not provide any recommendations regarding which geographical configuration would be most appropriate for Tanzania. This would have required a comparative analysis of the other options available, which is beyond the scope of the present study.

Finally, it should be noted that one limitation of the present report is inherent in its scope. As a country case study, most of the findings are specific to the Tanzanian situation, and are thus not necessarily transferable to other countries. While the East African region was covered to some extent by the data and interviews carried out in Arusha, additional analyses of the other two member countries of the EAC would have been necessary to provide a complete assessment of the integration process and potential implications of an EPA on the latter.

### 3 The Concept of Economic Partnership Agreements: Objectives, Regulatory Framework and Political Economy of Negotiations

#### 3.1 Co-operation between the EU and ACP Countries: Background

In June 2000 the EU and the ACP countries signed the Cotonou Agreement in Benin's capital, after which it was named. The Agreement replaced the Lomé Conventions, which, having been adapted several times, had been in place for 25 years. Among the aims of the new Agreement are to make the economic co-operation between the EU and the ACP countries compatible with WTO standards and to increase its effectiveness. The elements of an enhanced partnership for development and of politi-

cal dialogue between the partners are emphasised in the Cotonou Agreement. The two major pillars of the Lomé Conventions retain their place under Cotonou: trade and aid.

**The Lomé Conventions:** The main objective of the first Lomé Convention was to enhance the economic and social development of ACP countries by integrating them into the world economy. The EU granted the ACP countries trade preferences and opened its markets to all products originating from these countries apart from agricultural products and textiles.<sup>5</sup> Because the arrangement was not compatible with WTO rules, it required special approval through waivers. The most important achievement, especially of the last Lomé Convention, was to perceive the ACP countries as equal partners instead of as mere recipients of development aid. A result of this new approach can be found in the National Indicative Programmes (NIP) financed from the European Development Fund (EDF). Yet past EU-ACP development co-operation was unable to prevent ACP economies from being increasingly marginalized in global trade, and it failed to break the cycle of commodity export dependency. Moreover, the idea of partnership in development co-operation was not substantiated in any meaningful way.

**The Cotonou Agreement:** Despite displaying similarities with its predecessors concerning aid aspects, the Cotonou Agreement differs from Lomé essentially with respect to trade. The main objectives stated in the Cotonou Agreement are to reduce poverty in the associated countries, to contribute to sustainable development, and to integrate the ACP countries successfully into the world economy (Article 1). The latter objective is to be fostered not only by strengthening EU-ACP trade relations, as in the past, but also by enhancing trade relations among the ACP countries. To achieve this, the EU is encouraging ACP countries to engage in regional integration initiatives and to open up these initiatives towards the EU market. Economic Partnership Agreements are to become the main instrument to

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5 Exceptions were made for sugar, rice, bananas, and beef. The so-called commodity protocols still regulate the import of certain amounts of these products to the EU, allowing ACP exporters to benefit from higher prices within the EU.

pursue these objectives; they will be discussed in more detail below. Further attention was given to participation, structural reforms, and capacity building as well as to fighting corruption. The four main principles of the Cotonou Agreement are (Article 2):

1. Equality of the partners and ownership of the partner country
2. Participation of all stakeholders – state and non-state actors – of the partner country in defining objectives of economic and development co-operation
3. Political dialogue and mutual obligations, including respect of human rights, and
4. Differentiation in accordance with the varying needs and levels of development of the ACP countries, taking into account regional integration processes.

The ACP countries are expected to take on a more active role in shaping trade and development co-operation. The idea of a partnership on an equal footing engaging in economic and social co-operation became the main concept of the Agreement. The major innovations of the Cotonou Agreement as compared to the Lomé Conventions are thus its stress on political dialogue, performance-based aid, and the integration of new actors into development co-operation.

### 3.2 Reforming Economic and Trade Relations between the EU and the ACP Countries

The Cotonou Agreement is the general framework defining overall ACP-EU co-operation on economic and social development. Articles 34 to 54 of the Agreement then define more specifically the scope and content of future EPAs. Briefly spoken, EPAs are to define new trading arrangements that comply with WTO regulations (Article 36.1). EPAs are to be consistent with the overall development objectives agreed between the ACP countries and the EU. High importance is accorded to trade development within national and regional development strategies.

The Cotonou Agreement stipulates that EPAs are to be negotiated between the signatories starting in September 2002, and come into force on 1 January 2008.

The EPA concept encompasses three major principles:

1. EPAs are to include implementation of WTO-compatible free trade areas (FTAs) between the EU and the ACP countries, which essentially means that trade liberalisation will be reciprocal rather than unilateral.
2. To safeguard the interests of the ACP vis-à-vis an economically much stronger partner, special and differential treatment (SDT) will be accorded to them, which means that their lower level of development will be given due consideration.
3. EPAs will build on and enhance regional integration processes on the side of the ACP countries; consequently, they should be concluded with groups of ACP countries already engaged in regional integration initiatives rather than with individual countries.

The following subsections discuss the three main elements of future EPAs against the background of the respective WTO regulations, and highlight the potential implications for the ACP countries.

**WTO compatibility:** The EU Commission intends to establish WTO-compatible FTAs with the ACP countries. Trade liberalisation will thus, in accordance with Article XXIV of the GATT of 1994, cover “*substantially all ... trade.*”

Article XXIV leaves room for interpretation, as it merely states that:

- the eventual free trade agreement must be established within “*a reasonable length of time*”;
- and that trade barriers have to be eliminated on “*substantially all the trade between the constituent territories.*”

The WTO defines the “*reasonable length of time*” as full liberalisation in FTAs which “*should exceed ten years only in exceptional cases*”. FTAs between industrialised countries and developing countries and even more so LDCs constitute exactly the “*exceptional case*.” Hence, the exact length of the transition phase is subject to discussion.<sup>6</sup>

“*Substantially all ... trade*” is at present defined as 90 % + of all trade, without stipulating the absolute reference figure on which the percentage is to be calculated. Either trade volume prior to the liberalisation process between the partners or the number of product lines according to the common trade classification systems such as the Harmonised System (HS) may be taken as the base reference.<sup>7</sup> Both approaches only consider the variety of products being traded, not the potential financial value of free trade. They may therefore not be the most concise indicators for defining “*substantially all ... trade*”.

The rather vague definition of Article XXIV potentially gives some leeway to ACP countries negotiating an EPA regarding the coverage of products and longer implementation periods for the liberalisation process vis-à-vis the EU (also see special and differential treatment, below). Asymmetric liberalisation would reduce adjustment costs in two ways: first, by lowering the amount of revenue forgone via trade levies, and second by protecting sensitive sectors and infant industries. Longer implementation periods would give ACP economies more time to adapt to the new trade regime.

**Special and differential treatment:** WTO trade regulations provide for special and differential

treatment for developing countries and LDCs to reduce negative effects of trade liberalisation.<sup>8</sup> First, asymmetrical liberalisation allows developing countries and LDCs to liberalise less tariff lines by lower percentages of tariff reduction at a slower speed than industrial countries. Second, developing countries and LDCs may implement policies otherwise considered to be trade-distorting, such as the provision of domestic support for their agricultural sectors. Third, industrial countries may grant developing countries unilateral trade preferences by applying lower tariffs than the Most Favoured Nation (MFN) tariffs.<sup>9</sup>

The EU has used asymmetrical liberalisation in its FTA with South Africa; therefore it may be expected that it will also do so in EPAs with the ACP countries. As for the second option, the majority of developing countries and LDCs lack sufficient funding to implement policies for the support of certain sectors; but the Cotonou Agreement acknowledges “supply and demand side constraints” and “trade development measures as means of enhancing ACP states' competitiveness” (Article 35). Finally, one of the principle aims of EPAs is to end non-reciprocal preferential trade between the ACP countries and the EU, thus ruling out the third option, to provide special and differential treatment.

Where WTO Article XXIV provides a leeway due to unspecified regulation, SDT clearly allows for more flexibility on the side of developing countries and LDCs in any trade agreement or liberalisation commitment. On the other hand, as the EU wants to conclude EPAs with regions rather than with single countries, it would have to provide SDT for groups

6 In the case of the EU's FTA with South Africa, and in the Free Trade Area of the Americas (FTAA) for Mexico, transitional liberalisation periods of 12 and 15 years have been granted respectively (McQueen, 2002). The WTO has been notified of both agreements have been notified, but they are still under review.

7 Using the trade classification catalogues as a base reference will usually allow for more extensive liberalisation than historical trade volume, since actual trade is subject to protective policies and tariffs. The EU, for instance, protects selected agricultural goods, processed foods and organic chemicals to such an extent that trade liberalisation for whole HS chapters is at a standstill.

8 *Special and differential treatment* (SDT) has its origin in the Enabling Clause agreed upon in the WTO's Tokyo Round in 1979.

9 A country granting trade preferences under the provisions of SDT must outline such preferences in the General System of Tariff Preferences (GSP) and report these to the WTO secretariat. The General System of Tariff Preferences is the instrument at the heart of the “Enabling Clause” of 1971. It has been equipped with a waiver of the MFN principle for an indefinite period since 1979. The EU was the first to implement its own GSP Scheme in 1971, and since then it has granted developing countries tariff preferences.



of countries. It remains to be seen how each country's specific needs and developing interests in such groups can be catered for. Furthermore, among themselves ACP countries are likely to have conflicting interests in the SDT granted to them by the EU.

**Regionalization:** The EPA concept envisages strengthening regional integration on the side of the ACP countries. Thus the EU would wish for the ACP countries to enter EPAs as regional groups. The WTO agreement rules that FTAs will have to engage in reciprocal free trade rather than continue with (market-distorting) preferential trade of the kind granted under the Lomé Convention and currently still in effect until the conclusion of EPA negotiations. ACP countries, especially the least developed ones among them, will have to choose between two options: Either they may decide to establish economic unions with their regions (FTAs, customs unions) to conclude an EPA with the EU; this would mean reciprocal free trade with the EU. Alternatively, they may opt out of EPA negotiations – thereby also risking hampering integration efforts in their region – to avoid increased competition from both regional and European producers.

Article 37 of the Cotonou Agreement states that EPAs will be negotiated “*with ACP countries which consider themselves in a position to do so, at the level they consider appropriate.*” That is, theoretically, ACP countries may negotiate an EPA individually, but this alternative does not seem realistic for two reasons. First, neither from a political nor from an economic point of view does it seem feasible for ACP countries to step out of ongoing regional integration processes in order to retain current unilateral preferences in EU markets. Second, the Commission has made it quite clear that it favours the negotiation of regional agreements.

At the time of writing, some of the ACP countries had not yet taken a formal decision on the regional grouping with which they wanted to continue EPA negotiations. Tanzania can negotiate an EPA as a member of the Southern African Development Community (SADC) or of the EAC, while Kenya and Uganda could negotiate under the umbrella of the Common Market of Eastern and Southern Africa

(COMESA). Overlapping memberships clearly remain an unresolved issue in Eastern and Southern Africa that will not only complicate EPA negotiations but also hamper regional integration processes.<sup>10</sup> Economically sound and technically feasible solutions still need to be found.

The planned schedule for EPA negotiations is as follows: The first phase of EPA negotiations started between all ACP countries (represented by the ACP secretariat) and the EU Commission (represented by the DG Trade) in September 2002. In September 2003, phase II of the negotiations formally started at a regional level, but it was agreed at the same time between the signatories that phase I negotiations of the all-ACP group would continue in parallel. ESA and SADC announced in November that EPA negotiations at the regional level would be launched in February and March 2004, respectively. As the waiver currently granted by the WTO will phase out in 2007, the new agreement will need to come into force by 2008. The free trade area is set to be fully functional by 2020, i.e. after a transitional phase of 12 years.

### 3.3 Status of European Preferential Trade Arrangements – Implications for EPAs

As has been shown above, the Cotonou Agreement and subsequent EC documents have so far only vaguely defined the eventual shape of EPAs. In fact, some of the provisions appear to contradict other trade arrangements currently in place such as the EBA initiative covering the LDCs. In addition, it is not yet clear what concessions the EU is ready to make on the market access side in return for reciprocity or the expected phasing out of the commodity protocols. In order to identify the potential scope of EPAs more clearly, we analyse other trade regimes currently in place in the EU that may serve as a

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10 Tanzania withdrew from COMESA in 2001. Both EAC and COMESA announced their intention to establish a Customs Union by 2004. If the overlap remains in place, common external tariffs will have to be identical in both regional organisations.

benchmark for negotiation options. For an overview, see Annex C.<sup>11</sup>

The EU's General System of Preferences (GSP) on the one hand and the Everything-But-Arms Initiative (EBA) on the other are the nearest benchmarks for EPAs. ACP countries will have to gain in market access over and above the current GSP if they are not to be "worse off" than under Lomé. The "*superior tranche general system of preferences*" (Super GSP), better known as the Everything-But-Arms Initiative, for which currently only LDCs are eligible, offers duty- and quota-free market access on a unilateral basis. The GSP is thus the "bottom line" benchmark for EPAs, with EBA serving as the optimum in terms of market access regarding tariffs and quantitative restrictions. Both regimes and their pros and cons are analysed in more detail below.

Apart from the Cotonou Agreement, the EU is currently engaged in a number of bilateral free trade agreements with various developing countries. The WTO has been notified of these agreements, but the notification process is still under way. Of these agreements, the Trade and Development Cooperation Agreement (TDCA) concluded between the EU and South Africa in 1999 is one of the most relevant benchmarks for EPAs. It will also be considered in more detail below.

### **The European General System of Preferences**

The European GSP grants developing countries and LDCs preferential market access provisions better than those under MFN tariffs but less liberal than EU free trade agreements. This leads Stevens and Kennan (2001) to argue that:

*"The EU's effective trade policy has turned WTO terminology on its head. In practice, the EU's most-favoured regime is that provided under the Cotonou Agreement, the set of bilateral agreements that the EU has negotiated with its Southern and Eastern neighbours plus South Africa, and the Super GSP."*

The EU's GSP currently regulates preferential market access for 179 countries. These include all 76 signatories to the Cotonou Agreement,<sup>12</sup> nine other developing countries engaged in trade and co-operation agreements with the EU,<sup>13</sup> an additional nine non-ACP LDCs which benefit at the same time from the EBA-initiative; and six developing countries that are currently conducting negotiations on free trade and co-operation agreements with the EU.<sup>14</sup>

In general, the GSP sets percentage reductions for MFN tariffs for exporters from beneficiary countries. Fine-tuning in the composition and extent of preferences is defined by the scheme of the GSP, which provides individual regulations for different countries or groups of countries, e.g. the ACP group. More than half of the 179 GSP beneficiaries are granted additional preferences above the standard GSP.

Implementation of any preferential regime necessarily calls for rules of origin to regulate who is to benefit from the preferences and who is not. The point of rules of origin is to ensure that only the beneficiary country can take advantage of the GSP. They apply when a product of a beneficiary country is not fully "obtained" in that country, since inputs from third countries are used in it. As a rule of

11 We deliberately exclude the African Growth and Opportunity Act (AGOA) from this comparison. AGOA is not as comprehensive in terms of product lines as the EU trade regimes we look at. However, the promotion and implementation of the program appears to be more hands-on and quite effective in a number of the eligible countries, thereby in some respects providing a useful lesson to the European schemes in place.

12 This includes all ACP countries with the exception of Cuba, which did not sign the Cotonou Agreement. South Africa is an ACP member, but with a qualified membership. As stated above, the country has concluded a separate free trade agreement with the EU and enjoys observer status at EPA negotiations.

13 Currently in force are free trade agreements with Algeria, Morocco, Tunisia, the Palestinian Authority, Mexico, South Africa, Lebanon; in ratification: Egypt, Jordan.

14 Negotiations with MERCOSUR and Chile have been in progress since 2000; Syria has been negotiating on accession to the Euro-Med since 1998.

thumb, a minimum of 60 % of value added should be created domestically if a processed product is to qualify as originating in the exporting country. In some cases, the EU grants a “*cumulation of origin*,” which means that products containing inputs from specified countries are considered eligible for preferences as if they were obtained wholly in the beneficiary country.

The cumulation of origin for ACP countries is more generous than the regime imposed on standard GSP beneficiaries, providing for full cumulation among all ACP countries and EU member states. Still, there has been much criticism concerning the detrimental impacts of the current regime of rules of origin on ACP exports to the EU. Both the minimum transformation required – a two-stage transformation, for instance, applies for textiles and clothing – and the administrative procedures necessary for the certification of origin appear to be beyond the capacities of many ACP countries. Moreover, with preference margins constantly eroding, the rules of origin have become a more decisive factor for exporters than the actual tariffs – one of the potential factors held responsible for the low utilisation rate of trade preferences granted to developing countries and LDCs.

The EC has recently taken up this criticism and is undertaking a comprehensive review of its rules of origin regimes and their overall effectiveness.<sup>15</sup> For the ACP side, the eventual specification of the applicable rules of origin, i.e. the type of transformation required, certification procedures and the scope of cumulation may become one of the most critical issues during EPA negotiations.

Of roughly 7000 dutiable products included in the GSP, the EU has classified 3300 as non-sensitive to its domestic market and thus eligible to be exported duty-free. For the remaining 3700 sensitive products, GSP beneficiaries are granted tariffs lower than the respective MFN tariffs. Where certain contingency thresholds exceed levels that may threaten European producer competitiveness, sectors may either be graduated to 'sensitive' or be completely

“graduated out” of the GSP. If a beneficiary country exports “the lion's share” of one commodity to the EU, this country would also be graduated out of the scheme to assure fair distribution of preferences among the beneficiaries.<sup>16</sup> As the GSP applies for almost every developing country, ACP countries would benefit if strong developing countries and their respective sectors were graduated (Davenport 2002:35). An EPA is therefore expected to provide preferential market access for ACP countries well above the level of the standard GSP. It appears that it will not be an option to risk a loss of preferences or accept stricter rules of origin by “falling back” on the standard GSP-status.

### Super GSP – the Everything-But-Arms Initiative

Regarding market access, LDCs currently enjoy the most favourable trade arrangement with the EU. At present 40 ACP and 9 non-ACP LDCs enjoy duty- and quota-free export status with the EU, except for arms and ammunition.<sup>17</sup> The remaining quantitative restrictions for three sensitive agricultural products are subject to a staged phasing out: Restrictions for bananas will end in January 2006; for sugar in July 2009; and for rice in September 2009. For those ACP countries that are currently benefiting from the commodity protocols, the EBA regime is less favourable, since it does not provide for fixed country quotas. This will raise competition among exporters and eventually lower prices received for protocol products on the EU market.

Without doubt, the EBA regime is the most favourable trade regime currently in place. However, with a view to EPA negotiations a number of questions need to be raised in terms of applicability and consistency of trade preferences given to the ACP

15 See Green Paper on the Application of Rules of Origin, European Commission, 2003.

16 Davenport (2002: 38) identifies only 5 HS chapters of interest as potential markets for increased competition between ACP countries and non-ACP GSP-beneficiaries, namely fish (03), fruit, nuts (08) fats and oils (15), beverages (22), and aluminium (76).

17 The nine non-ACP LDCs currently eligible for EBA are mainly Asian countries and include, among others, growingly competitive countries like Bangladesh and Vietnam.

countries. First and foremost, the EBA initiative bears the risk of driving a wedge between ACP *developing countries* and ACP LDCs, especially where they constitute mixed memberships in regional initiatives. Would the LDCs have to give up their current preferences? Or would the EU grant the same unrestricted market access to all members of an EPA, regardless of whether they are LDCs or non-LDCs? This would essentially mean extending the EBA preferences to all ACP countries, a position that some EU member states have favoured but which may not find enough supporters within the EU.

Second, it is as yet unclear how the commodity protocols will be treated under EPAs. If they are phased out as under EBA, a number of current beneficiaries may face severe income losses in the respective sectors. At any rate, these countries would be 'worse off' than under Lomé. The European Commission still has to present a consistent solution for the planned revision of the commodity protocols under EPAs.

Third, if ACP countries are eligible for EPA rather than EBA conditions, they want to ensure that they remain on a similar footing with other beneficiaries of the EU's preferential trade regimes. ACP countries clearly face an erosion of their traditional preferences, because more and more other developing countries are becoming beneficiaries of similar preferences. But they may face even tougher times if a group of countries like the 9 competitive non-ACP LDCs get even more favourable market access to the EU than the ACP under EPAs.

The EBA regulations stipulate that the special arrangement for LDCs should be maintained for an unlimited period of time, thus exceeding the validity of the GSP scheme. On the other hand, the EU can withdraw the unilateral preferences at any time; change the criteria of eligibility, etc. As discussed above, it remains unclear whether and how the EU will guarantee LDCs their current preferences when,

in the near future, they become members of regional EPAs.<sup>18</sup>

At first glance, no LDC would appear to be well advised to enter EPA negotiations. Considering the unclear definitions on "substantially all trade" in the EU's current trade agreements, one risk of EPAs seems obvious. The liberalisation of only 90 % of traded tariff lines by the EU (as opposed to "everything"), and with the remaining 10 % being mainly of agricultural origin, ACP LDCs will be worse off with a WTO-compatible EPA than with EBA. While for developing countries the objective is to improve market access above the standard GSP, for LDCs the goal is clearly to secure the EBA status. Hence, for the ACP countries it is advisable to negotiate for unrestricted EBA market access for all EPA countries. However, recalling the protracted negotiations between South Africa and the EU, there is reason to be sceptical as to whether the agricultural lobbies in the EU member states will not put up heavy resistance to this option (see Box 1).

### **The EU-South Africa Trade, Development and Co-operation Agreement**

After negotiating for over three years, South Africa and the EU concluded the so-called Trade, Development and Co-operation Agreement (TDCA) in 1999. The TDCA provides for a free trade area between the signatories and covers a number of trade-related areas. It is moreover development-oriented and includes provisions for technical and financial assistance. The TDCA therefore comes close to the EPA concept, but with the important difference that South Africa is a more advanced and industrialised country than the ACP countries. Hence the assumption that EPAs should be more flexible than the TDCA in terms of its interpretation of how substantial all trade is as well as in its application of the principle of special and differential treatment.

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18 It should be noted that all regional groupings in Africa (including for instance EAC, ECOWAS, COMESA, and SADC) are mixed groups of least developed countries and developing countries.

**Box 1: The Political Economy of Economic Partnership Agreements**

The European Commission (EC) is certainly following a political rationale with its trade policy, over and above the objectives and eventual economic content of EPAs, as described above. The EC, for instance, intends to increase its influence in the WTO by strengthening its partnership with the ACP countries.<sup>19</sup> There is hence a case for the EU to make EPAs a success: If they fail to result in substantial benefits for ACP countries, there would not only be a risk that conflicts might arise between the EU and the ACP countries, but also that these might continue on WTO grounds. Moreover, the EU hopes to expand its network of bilateral trade arrangements, and thus to enlarge its foreign trade in advance of and beyond the commitments made in ongoing WTO negotiations. Even though the ACP group is not an economic heavyweight, it is relevant enough as a potential destination for European investors, especially in view of its large and in many instances yet untapped reserves of natural resources.

From the outset, the initiative for EPAs was on the side of the EU; the ACP countries are now “forced to react.” The Cotonou Agreement raises the claim to improve ownership and true partnership on the side of the ACP countries. However, EPAs are far more complex than the Lomé Conventions and capacity for trade negotiations on the side of the ACP countries is limited. Experience with other bilateral trade agreements recently concluded by the EU show that negotiations can be long and protracted, and that negotiation skills and power are decisive factors for the eventual outcome.<sup>20</sup> If they followed an economic rationale, the ACP countries would mainly bargain for the EU to reduce its strong domestic support in the agricultural sector. This would not only increase their international competitiveness in agriculture but also relieve their own agricultural sectors. From a political point of view, ACP countries must, however, be aware of the strong opposition from the European agricultural lobbies and of the pressure that eastern enlargement means for the EU. Other international fora are more appropriate to negotiate on the highly sensitive issue of European agricultural subsidies.<sup>21</sup>

The question is therefore whether EPAs realistically have the potential to open up new opportunities for ACP countries. ACP negotiators are obviously the far weaker partners in the negotiations. EPA negotiations will draw heavily on scarce resources, both financial and human. Even if ACP countries joined forces in regional groups and establish negotiation teams, this would call for additional coordination and harmonisation efforts on their side. None of the groupings currently in place has a mandate or the experience needed to negotiate as a group.<sup>22</sup> On the ACP side, EPAs will in all likelihood be agreements based on and signed by individual states – not regional blocks. Currently, the decisions of ACP states in Eastern and Southern Africa for the configuration under which they wish to negotiate an EPA even run counter to the interests of regional organisations such as EAC and SADC. Thus, instead of strengthening regional processes, EPAs also have the potential to undermine them – even if the intention of the European Commission was not to “divide and conquer” as some may suspect.

19 Note that from 2004 the EU will be comprised of 25 countries, and there are 77 ACP signatories to the Cotonou Agreement. Together they account for well over half of all independent nations. EPAs will thus be trade agreements on a global scale.

20 Negotiations between the EU and South Africa took more than three years, and although South African negotiators proved tougher than had been expected by most observers, the outcome was disappointing, particularly for producers and exporters in the agricultural and agro-processing industries.

21 This could in turn undermine the strategic solidarity of EU ACP co-operation, though.

22 SACU is a potential exception, but there positions on trade policy are ‘harmonised’ among member states, mainly because South Africa takes the lead. EAC member states have decided to negotiate separately for EPAs, even after their heads of state had declared, in November 2002, that the group would henceforth “negotiate as a block.” These issues are discussed in more detail in Ch. 5 and 6 below.

The TDCA also takes into account the different levels of development of the two parties and allows for differentiation both in sectoral coverage as well as in the phasing in of trade liberalisation. By 2010, 95 % of all South African exports will enter the EU free of duty, i.e. after a transition period of 10 years. The bulk of liberalisation on the EU side is to be effected within the first four years. South Africa for its part will liberalise 86 % of EU imports within a transition period of 12 years. Most industrial products will be liberalised only towards the end of this period. The TDCA also aims for WTO compatibility, which means among other things that no important sector could be excluded completely from liberalisation. The process of notification is unfortunately still ongoing. Consequently, no firm conclusion can be drawn yet whether coverage of merely 86 % of product lines and a transition period of 12 years will be acceptable to the WTO.

Potential problems may also arise from the fact that both parties have exempted large parts of their agricultural sectors from liberalisation. The high overall percentage shares of duty-free trade are at least in part due to tricky arithmetic. On the EU side, only 60 % of all agricultural product lines imported in the base year 1995 will be liberalised under the TDCA. In addition, the EU has made a number of products like wine and spirits subject to a separate accord and insisted, among other things, on the renaming of products such as Grappa, Ouzo, Chardonnay or Feta Cheese when they originate in South Africa. Other sensitive products exempted from free trade by the EU include beef, sugar, dairy products, fresh and prepared fruit, maize and cut flowers, which represent some 3.5 % of total imports from South Africa, based on 1995 trade volumes. Even during prolonged negotiations, the South African negotiators were unable to achieve a more favourable outcome in these important sectors.

Another important drawback were the rules of origin that the parties agreed on but which are detrimental to the interests of South African producers. The rules are product-specific and very complex in nature, as various measures are combined to assess the amount of value added originating in South Africa or the EU. The rules of origin are difficult to comply with as they usually require double trans-

formation and, moreover, compliance is costly to assess. As a result, the rules of origin applicable under the TDCA cannot serve as a model for EPAs.

The TDCA is still an important benchmark for EPA negotiations in two respects:

1. On a more positive note, it has provided a new and more flexible interpretation of the 'substantially all ... trade' clause in terms of the length of the transition period and product coverage.
2. On the negative side, negotiations on the TDCA have again highlighted the EU's apparently insurmountable stakes in the agricultural sector, and its lack of flexibility in terms of addressing non-tariff barriers to trade in a meaningful way.

Nevertheless, negotiators from South Africa have made some very important experience in negotiating a trade agreement with a powerful partner such as the EU. This experience and the capacity that has been built on the South African side during the process (and during ongoing discussions at the WTO level) can be of direct relevance for EPA negotiations. This applies in particular to SADC, of which South Africa is a member, but also more generally at the all-ACP level, where South Africa is also represented due to its qualified membership.

### **Implications for EPA Negotiations**

The EU Commission envisages reciprocal free trade under EPAs. For the non-LDCs of the ACP group, falling back on GSP preferences would imply that they were to be worse off than under Lomé. For them, negotiating an EPA offers a better opportunity under two conditions. First, market access to EU markets must improve, e.g. through a combined further dismantling of remaining tariffs in the sensitive sectors and a simplification of rules of origin. Second, a reciprocal opening up of ACP markets to EU imports needs to take into account the development levels of ACP countries in terms of transition periods and product coverage and at the same time to provide for measures to help their economies adjust.

For LDCs, the implications are slightly different. Since 2000 the EU has granted these countries free market access through EBA. On the EU side, agricultural subsidies, standards and rules of origin are among the factors that play a role. One important reason for the current under-utilisation of preferences, however, seems to lie in supply side constraints, which result, among other things, in high transaction costs. Adopting reciprocity entails a particularly high risk for those LDCs whose budgets depend on revenue from tariffs. By definition, LDCs are highly vulnerable to trade fluctuations and are constantly faced with the risk of balance of payments problems.

EPAs may moreover entail particular risks for the agricultural sector of all ACP countries. The EU's Common Agricultural Policy (CAP) still provides for market-distorting domestic support and export subsidies. Further opening up the agricultural sector of their own economies is therefore a problem for all ACP countries and particularly LDCs, which are largely reliant on agricultural production and exports. Unfortunately, EPA negotiations are not the right forum to reform the CAP. However, ACP countries should take every opportunity, including EPA negotiations, to urge the EU to liberalise its still highly protected agricultural markets, as this would allow the ACP countries to make appropriate use of their comparative advantages.

Summing up, the following issues are priorities for the negotiation agenda:

1. The ACP countries will want to improve their market access to the EU during EPA negotiations. In terms of further tariff reductions, the ACP countries want to jointly negotiate for nothing less than duty- and quota-free access, as currently provided to the LDCs by the EBA initiative.
2. ACP countries should aim to eliminate unnecessary non-tariff barriers to trade and to simplify rules of origin on the side of the EU. Cumulation of origin should be extended to other developing countries.

3. Targeted measures should be used to support ACP countries' own efforts to comply with and monitor standards.
4. EPAs need to provide for generous transition periods and exemptions to take into account the different level of development and special needs of the ACP countries. Special and differential treatment should be applied wherever possible.
5. Special safeguards should be used to ensure that ACP countries do not suffer from sudden import surges or market distortions caused by the CAP or other European policies.
6. Regional integration processes should be given priority over EPAs wherever there is a clash of objectives, resource allocation or sequencing of activities.
7. In order to ensure a successful outcome of negotiations it will be essential for ACP countries to build trade negotiation capacity at the national and regional levels. This should include systematic knowledge sharing with a more advanced and experienced partner such as South Africa.

#### **4 Fiscal, Economic, and Social Impact of EPAs**

Finding the best negotiation strategy for Tanzania is a difficult task. Because EPAs are not yet clearly defined, their eventual impact on ACP economies cannot be predicted precisely. Moreover, impacts will differ between countries depending on the actual share of trade affected, on trade and fiscal policies in place at the time of implementation, and on the responsiveness of each economy to the changes introduced by EPAs. The Tanzanian authorities had not yet commissioned a national impact study at the time of writing. However, a comprehensive assessment of the potential economic, fiscal and social implications of an EPA with the EU is essential for formulating a coherent and economically sound negotiation strategy. In other words, Tanzanian

decision makers need to know more clearly what is economically and socially at stake during EPA negotiations.

The present chapter provides a first assessment of the potential risks and opportunities arising from an EPA. After a brief description of the status of Tanzania's trade policy, three intertwined aspects of a new reciprocal trade agreement with the EU are discussed:

- the fiscal impact and associated welfare effects;
- the economic impact on various sectors; and
- the social implications involved.

We would like to stress at this point that while the present report highlights the main implications of EPAs, there is a need for a more thorough and comprehensive impact analysis at industry level. In particular, one would want to look in more detail at the effects on the main economic sectors such as agriculture and agro-processing, and at the respective social implications, especially the impact on incomes and employment. This was beyond the scope of the present study.

## 4.1 The Current Trade Regime

### 4.1.1 Trade Policy

Tanzania's trade policy is spelled out in a recent document drafted by the Ministry of Industry and Trade (MIT 2003). While containing a clear vision and mission, and an activities and implementation schedule, Tanzania's trade strategy seems to be too generic and not linked well enough with the actual situation of the economic sectors. Moreover, though new, the trade strategy document does not reflect on the role of trade policy as a part of the Tanzanian Poverty Reduction Strategy (PRS). Vice versa, the Tanzanian PRS makes no mention of trade policy as one of the relevant policy tools. Whatever changes may be introduced to Tanzania's trade regime in the near future, it is a severe omission that so little has been done to embed trade policy in the broader fab-

ric of national economic and development strategies and policies.

Tanzania's trade policy has undergone great changes over the last decade. Until the mid-1980s it was largely dominated by regulatory measures such as price controls, trade restrictions, single marketing channels and confinement policies. However, beginning in the late 1980s, successive governments have undertaken substantial steps towards opening up the economy, gradually liberalising the external sector by eliminating most export restrictions and foreign exchange controls, followed by an opening up for imports of foreign goods and services. In 1995, Tanzania was a founding member of the WTO.

Tanzania is moreover engaged in two regional integration processes, namely in SADC and the EAC, both of which put an explicit emphasis on economic integration by means of regional trade liberalisation. EAC is currently preparing for a Customs Union, with a common external tariff to be implemented starting in 2004. In SADC, the implementation of the SADC Trade Protocol is under way and the SADC Free Trade Area (FTA) is set to be completed by 2008. SADC envisages implementation of a Customs Union by 2010. Both regional integration schemes contribute to trade liberalisation in the region and limit the level of discretionary policy interventions. Whether they will foster Tanzania's trade integration with third countries is less clear, though, as several countries in the region currently apply higher tariffs than Tanzania. Establishment of a common external tariff (CET) within EAC or a harmonisation of external tariffs within SADC may therefore slow down rather than accelerate further trade liberalisation for Tanzania.

Alongside trade liberalisation, the Tanzanian government is committed to actively encouraging and facilitating foreign direct investment (FDI) through the Tanzania Investment Centre (TIC), an investment promotion agency, as well as by establishing export processing zones (see Box 2).



Tariff Rate	Items
0 %	Agriculture tractors and fertiliser Raw materials and machinery
10 % (2 %) <sup>a</sup>	Replacement parts and capital goods
15 % (3 %) <sup>a</sup>	Finished inputs, motor vehicle spare parts
25 % (5 %) <sup>a</sup>	Consumer goods
<sup>a</sup> Preferential rate for EAC members	
Source: Tanzania Revenue Authority	

### The Current Tariff Regime

Tanzania's tariff regime underwent various reforms since the late 1980s, resulting in a reduction of import duty bands from 18 different tariff categories in place in 1988 to a four-tier structure in 2001/02 (see Table 2). The four tariff rates of 0 %, 10 %, 15 %, and 25 % apply to product categories according to their respective degree of processing (Lyakurwa et al. 2001: 34). The 0 % rate applies for all imports of raw materials, replacements, and parts. Semi-processed inputs, spare parts (except for motor vehicles) and most capital goods are subject to duty of 10 %, while fully processed inputs and motor vehicle spare parts are charged at a rate of 15 %. The highest rate, 25 %, applies for finished consumer goods.

Starting in 2004, the CET for EAC is expected to replace the current tariff rates. The three-tier structure will be set at 0 %, 10 %, and 25 % (Lyakurwa et al. 2001:34). How the current intermediate bands will be merged to form the single intermediate rate of 10 % for Tanzania was not yet clear at the time of writing.

Due to its escalatory nature this tariff structure leads to far higher effective than nominal rates of protection for processing activities carried out domestically. In addition, a so-called "suspended tariff" of up to 50 % is collected on a number of sensitive import items that are also manufactured in Tanzania. While officially in place as an instrument against unfair dumping practices, suspended tariffs in Tanzania tend to be used as a protective measure for uncompetitive domestic industries.

### Box 2 : Export Processing Zones

Tanzania's national trade policy provides for the establishment of special export processing zones (EPZs), which are intended to attract investments into export-oriented economic activities by means of tax incentives and the provision of appropriate infrastructure (Ministry of Industry and Trade 2003:42). Operations in an EPZ are exempt from all kinds of taxes and are allowed to sell up to 20 % of their output to the domestic market. Tanzanian policy makers put high hopes in EPZ, whereas most international observers are less enthusiastic. It is often argued that backward linkages of the kind expected from an EPZ do not automatically develop and that the opportunity cost of an EPZ caused by distortions may exceed the benefits.<sup>23</sup> In the case of Tanzania it must even be feared that the EPZ will not attract substantial investment, as many investors might – despite tax exemptions – shy away from high costs for utilities like energy and water.

23 For a comprehensive discussion of EPZ policy in Tanzania, see Madani (1998).

EAC members are granted preferential tariff rates, namely 0 %, 2 %, 3 %, and 5 %. However, exporters from Tanzania's EAC partners Uganda and Kenya are also faced with suspended tariffs of up to 25 %, and these often cancel out the preference margin accorded to them over other trading partners. Since 2001, Tanzania has implemented its differentiated tariff phase-down vis-à-vis SADC members other than South Africa. Reflecting the asymmetrical nature of the SADC FTA, least developed countries like Tanzania liberalise more slowly than South Africa, and tariff phasing differs between South Africa and the other SADC member states.

In principle, import duties refunded on inputs used in the production of export goods (Tanzania Revenue Authority 2003), but so far the duty drawback system has not been working very well.

In addition to tariffs, certain imported consumer goods are subject to excise duties. Excise duty is charged either on specific or ad valorem tax rates, the rates being 5 %, 10 %, and 30 %. Imports subject to specific excise rates include spirits, tobacco and petroleum products. VAT is collected at the standard rate of 20 % on all imported goods. Tariffs, excise duties, and VAT are all subject to an extensive regime of exemptions, leading to great differences between nominal rates and effectively collected revenue. For instance, total exemptions from VAT amounted to 31 % of all collectible VAT in 1999 (*ibid.*). As exemptions usually benefit domestic producers rather than external ones, extensive use of exemptions may well result in additional protection of domestic producers. In Tanzania, there are indications, for instance, that imported goods are subject to excise duties and VAT where the same domestically produced goods are exempt from these surcharges. There is evidence of substantial revenue leakage due to exemptions in Tanzania (Rajaram 1999: 15).

Imports moreover are bound up with other transaction costs that may raise their price substantially. One of the more contentious ones is the pre-shipment inspection carried out by an agency under contract to the Tanzanian Revenue Authority (TRA). Imports whose f.o.b. value exceeds US \$

5,000 are required to undergo this inspection. The importer is charged a minimum cost of 1.2 % of the f.o.b. value, hence raising the price of the imported good and adding considerable red tape to import procedures.

## 4.2 Fiscal Impact

One of the most controversial issues of EPAs is their potential fiscal impact on ACP countries, i.e. the loss of revenue expected to follow tariff elimination towards the EU. While this is a real threat, it is by no means an automatism as often suggested by political rhetoric. Much depends on the evolution of actual trade flows. Moreover, we are convinced that the realms of trade policy and revenue collection should be kept apart whenever possible, in order to adopt and maintain a more transparent and efficient trade policy framework that is not subject to fiscal motives. However, it must be acknowledged that in most developing countries, including Tanzania, tariff collection plays a highly important role in public revenues, and consequently fiscal aspects of present and future trade regimes need to be taken into due account. In the case of Tanzania, taxes on imports amount to roughly one third of total public revenue.

The aim of the following paragraphs is therefore to contribute to a rationalisation of the ongoing discussion on the fiscal impact of EPAs. First, we provide a rough quantification of the expected revenue loss due to an FTA between the EAC and the EU. The reason why we decided in favour of this scenario is the EAC's current moves towards forming a customs union. The methodology applied can also be used for any other EPA constellation. In addition, because revenue leakage due to exemptions is still of substantial magnitude in Tanzania, as noted above, we adopt a methodology that takes these exemptions explicitly into account. In doing so, we find that the incurred revenue loss may be less severe than is commonly suggested.

Second, we will highlight an important caveat concerning the discussion of possible ways to compensate for the suggested revenue loss by further rationalising Tanzania's exemption regime and im-

proving revenue collection. To some extent, exemptions from tariffs and other government taxes may make sense from an economic and trade policy point of view, and sometimes leakages may simply be caused by limited administrative capacity. The important issue is, however, that exemptions and leakages often reflect the interests of influential groups or individuals. Wherever or not this is the case, any attempt to eliminate such leakage could meet with stiff political opposition. The assumption is that, therefore, it may be much more difficult to make up for revenue loss through further rationalisation of revenue collection than is usually acknowledged.

#### 4.2.1 Background and Methodological Approach

The fiscal implications of the trade liberalisation implied by an EPA are mainly due to two trade effects, commonly known as trade creation and trade diversion. In addition, certain dynamic effects play an important role, for example a move towards higher growth rates induced by an increased influx of foreign direct investment. While the latter are difficult to quantify in an *ex ante* analysis, the former two lend themselves quite readily to an analysis of the potential fiscal impact of trade liberalisation based on comparative statistics.

**Trade Creation:** One of the main arguments in favour of regional economic integration, and even for trade liberalisation in general, is trade creation. Eliminating or lowering trade barriers between two or more countries potentially induces greater trade volumes between these countries, generating gains from differences in comparative advantages and factor endowments by means of division of labour. Generally, this should lead to greater welfare for all members to such an agreement. While, therefore, reduced tariffs provide considerable scope for increased revenue due to a broader tax base, their complete elimination will – other things equal – inevitably lead to a loss of tariff revenue. However, compensation for thus reduced public revenue could in principle be levied via other taxes on imported goods or from alternative sources in the economy.

**Trade Diversion:** At the same time, however, a move to free trade between two or more countries that at the same time maintain their external trade barriers towards the rest of the world, could have a welfare-decreasing effect on these countries. This is due to the fact that with tariffs between the member economies eliminated, consumers might switch from more efficient producers in non-member states to less efficient suppliers from within their particular FTA, diverting trade flows from non-members to members – hence the term “trade diversion.” The trouble with trade diversion is that even if it should leave consumers of the relevant products in the importing country better off, it can still lower the overall welfare of the economy, as the treasury foregoes revenue from tariff collection. Obviously, this effect can have distributional consequences as well.

Numerous studies exist on the potential revenue effects of regional integration initiatives, which adopt a methodology based on a trade diversion – the trade creation scenario. However, we know of only one explicitly concerned with an FTA between the EAC and the EU, namely McKay et al. (1998). They derive an upper limit for tariff revenue loss attributable to such an FTA of as much as 73 % of total tariff revenue, or 0.5 % of GDP for Tanzania, based on 1995 data. Other things equal, this would translate into a loss of 20 % of total tax revenue.

Other authors have examined the potential revenue impact of the EAC Customs Union, which can be considered the first step in assessing the impact of an EPA between the EAC and the EU. However, to our knowledge most of these studies base their estimates on nominal tariff rates, and thus do not take into account the considerable extent of tax exemptions granted in countries like Tanzania. In order to give the reader some impression of the magnitude of this feature of Tanzania’s tax regime, Table 3 shows the value of exemptions granted in 2000/01 in Tanzania. The draft Institutional Review on trade policy (Institutional Review 2002:54) reports that over 40 % of potential tariff revenue might be lost due to tariff exemptions.

These numbers indicate that any calculation of the revenue impact of EPAs that does not take into account exemptions from tariffs and other taxes will

<b>Institution</b>	<b>Value in mil TSh</b>	<b>As % of total tax revenue</b>
Government institutions	33,943.9	3.5
Para-statal institutions	2,768.8	0.3
Religious and charitable organisations	13,517.7	1.4
NGOs	25,812.1	2.6
Private companies and individuals	55,387.4	5.7
TIC	33,368.1	3.4
<b>Total</b>	<b>164,798.0</b>	<b>16.9</b>

Note: Values include exemptions on import duties, VAT and excise duty on imports  
Source: Lyakurwa et al. (2001)

	<b>Revenue change - FTA with EAC</b>		<b>Revenue change - FTA with EU</b>		<b>Estimated Total Impact</b>	
	mil TSh	As % of Total Tax Revenue	mil TSh	As % of Total Tax Revenue	mil TSh	As % of Total Tax Revenue
Scenario 1 $\epsilon_d = 0.5$ $\epsilon_s = 2$	4,760	0.5	-37,000	-3.8	-32,300	-3.3
Scenario 2 $\epsilon_d = 0.25$ $\epsilon_s = 1$	-50.4	0.0	-26,400	-2.7	-26,400	-2.7
Scenario 3 $\epsilon_d = 1$ $\epsilon_s = 4$	14,400	1.5	-58,400	-6.0	-44,000	-4.5

Source: Authors' calculations based on data provided by TRA

inevitably overestimate the loss of revenue collection due to tariff elimination by a considerable factor. We therefore suggest a method that takes into account exemptions from all taxes collected on imports in an explicit manner.

#### 4.2.2 Estimate Results

Table 4 reports our estimate results. We calculate three scenarios: one following Gitu et al. (2003) in applying medium-range elasticities of demand and substitution and – following Rajaram et al. (1999) – two in which we assume a plausible upper and

**Box 3: Potential Revenue Implications for Zanzibar**

The United Republic of Tanzania is formed by the Mainland and Zanzibar, which comprises the two Islands Unguja and Pemba. Under the Union's Constitution, Zanzibar has its own Constitution and enjoys far-reaching autonomy, which is reflected in the fact that it has a number of government institutions of its own, including presidency, cabinet, legislature, and judiciary. Apart from this particular political status and its geographical separation, Zanzibar also differs from the Mainland in that its dependence on imports, both to meet the needs of its economy and for public revenue, is even more pronounced than on the Mainland. Imports from Kenya account for 20-25 % of local requirements, rendering the potential revenue impact of tariff elimination within the EAC potentially more severe than for Mainland Tanzania.

While tariffs and taxes are widely harmonised between Zanzibar and the Mainland, the islands' government does have some discretionary power regarding evaluation methods and the application of suspended duty: Suspended duty is not collected on imports entering Zanzibar, and often a higher minimum dutiable value (MDV) is applied. In general, Zanzibar pursues a somewhat less protectionist trade regime than the Mainland, reflecting the fact that there is not much industry to protect on the islands and as a result rates of protection differ between the Mainland and Zanzibar. Consequently, no imports landed in Zanzibar are allowed onto the Mainland (though they are in the opposite direction). This has serious revenue implications for Zanzibar, as there is no mechanism to distribute customs duties collected at the port of entry between the two members of the Union.<sup>25</sup>

Moreover, in part due to deteriorating harbour facilities, direct imports have been declining and an important share of Zanzibar's imports is landed in Dar es Salaam. This deprives the Zanzibar treasury of considerable amounts of revenue and the problem will only be exacerbated if the Mainland eliminates trade barriers on Kenyan exports in the course of implementation of the EAC customs union. The issue of finding a new formula for revenue sharing is on the agenda of a Joint Fiscal Committee, provided for in the Union's Constitution, but an agreement is not yet in sight. For the time being, it must be feared that any revenue loss incurred by the Zanzibar treasury will be even more severe and substantial than for the Mainland.

lower limit for elasticities of demand and substitution.<sup>24</sup>

The estimated impact of an EAC FTA is positive in two of the three scenarios, but minimal in all three, ranging from roughly 0.0 percent (-50.4 mil TSh) to about 1.5 percent (4,760 mil TSh) of total tax revenue, which amounted to 975,385.5 mil TSh in the fiscal year of 2001/02. By contrast, the ceteris paribus revenue impact accruing to an FTA with the EU as reported in column 2 is negative and of a larger magnitude, resulting in a negative overall effect, which is reported in column 3. However, the revenue loss we derive for an FTA with the EU following the elimination of all import tariffs towards Kenya and Uganda is far lower than suggested in McKay et al. (1998), and ranges from 26,400 mil TSh to 44,000 mil TSh, or from 2.7 to 4.5 % of total tax revenue. While not dramatic, these numbers are

not negligible either, and alternative sources of revenue ought to be found in order to compensate for the expected loss. The fact that our results are not overly sensitive to substantial variation of the underlying assumptions (i.e. the assumed elasticities) suggests that our estimates should be of roughly the right magnitude.

### 4.2.3 Conclusions on Fiscal Effects

The revenue impact of tariff elimination we derive from our analysis of actually collected tariffs is less dramatic than has been argued in previous studies, which base their estimates on nominal tariffs. With regard to tariff elimination within the EAC we even find a positive revenue impact for Tanzania.

24 For a detailed description of the applied methodology see Annex D.

25 However, there is such a mechanism for redistributing revenue collected in the form of VAT on goods shipped from one part of the Union to the other.

While these results are rather reassuring in contrast to the often claimed dramatic negative fiscal impact of EPAs, the underlying reasons are on the contrary quite worrying with regard to possible compensatory measures. It must be assumed that the extensive exemptions we observe only in part reflect administrative weaknesses or socially desirable exceptions from an otherwise efficient system. More probably, they are to some extent the result of strong economic and political interests of single groups or individuals in society or abroad (Lyakurwa 2001: 33). Such exemptions would have to be overcome against potentially strong political resistance if the occurring revenue loss is to be compensated for by rationalising the exemptions regime, as is commonly suggested (cf. Mduma and Msole 2001:38). We therefore propose that in discussions of counter-vailing measures such interests should be taken duly into account and any proposed solutions should be scrutinised with regard to their political feasibility. By no means do we wish to suggest that vested interests should not be challenged in the course of policy formulation. Rather, we wish to stress that they must not be overlooked during this process.

### **4.3 Economic Impact – Risks and Opportunities for Tanzania**

Besides having fiscal implications, trade liberalisation is bound to have a direct impact on Tanzania's private sector. The elimination of import tariffs renders foreign producers more competitive in the domestic market, hence raising competition for Tanzanian producers of both intermediate and final products. Again, this increase of competition is reflected by the estimated amount of trade creation. However, reciprocal trade liberalisation should also translate into increased competitiveness for Tanzanian exporters as well. Tanzanian producers who use imported intermediates in their production process that currently still face tariffs should be able to benefit from further trade liberalisation under both the EAC FTA and the EU FTA, no matter whether they sell in domestic or international markets.

Regarding trade relations with the EU, new export opportunities for Tanzanian producers in EU markets will in all likelihood only materialise if remain-

ing NTBs are eliminated, given the fact that most Tanzanian products already enjoy duty free market access under the EBA initiative. As far as the regional integration process is concerned, realisation of economies of scale in an enlarged market will depend on a number of additional factors rather than mere tariff elimination, e.g. harmonisation of business laws and tax regimes, reduction of transport and transaction costs, or adoption of a common investment code and competition law.

Consequently, along with the static effects, the creation of larger markets through FTAs should generate certain dynamic effects for the member states' economies. The single most important one is due to economies of scale: If the newly created markets are large enough to exploit economies of scale, investment in growth-generating industries may become worthwhile where fragmented markets were too small in the past. In addition, FTAs are assumed to lock-in their members' commitment to trade liberalisation and other economic reforms, thus contributing to a more favourable investment environment altogether.

While economies of scale are certainly an argument in favour of regional integration, it should be kept in mind that with regard to trade liberalisation towards the EU, Tanzania is about to open up its markets for producers who serve a very large home market and therefore already realise considerable economies of scale. These result in higher efficiency of production and marketing processes. If these producers gain free access to the EAC, the scope for new investment to be attracted even into an enlarged East African market may be limited.

In addition, the threat posed to East African manufacturers by EU suppliers might also have a detrimental effect on East African economic integration itself. If Tanzanian consumers substitute away from regional producers to EU suppliers, who – due to their larger home market – already benefit from larger economies of scale than, for example, Kenya, regional economic links within the region might come under stress. This would be inconsistent with the EU's declared goal to use EPAs as a means to enhance regional integration of ACP economies.

Both the regional integration process and reciprocal trade liberalisation towards the EU bear opportunities as well as risks for Tanzania. However, since opportunities and risks accruing to each of these processes need not be the same, it seems appropriate to examine the potential economic impact of the regional integration process and of an EPA with the EU separately. To do so, we first provide a brief overview of Tanzania's external sector, before we deal with each liberalisation process separately in section 4.3.2.

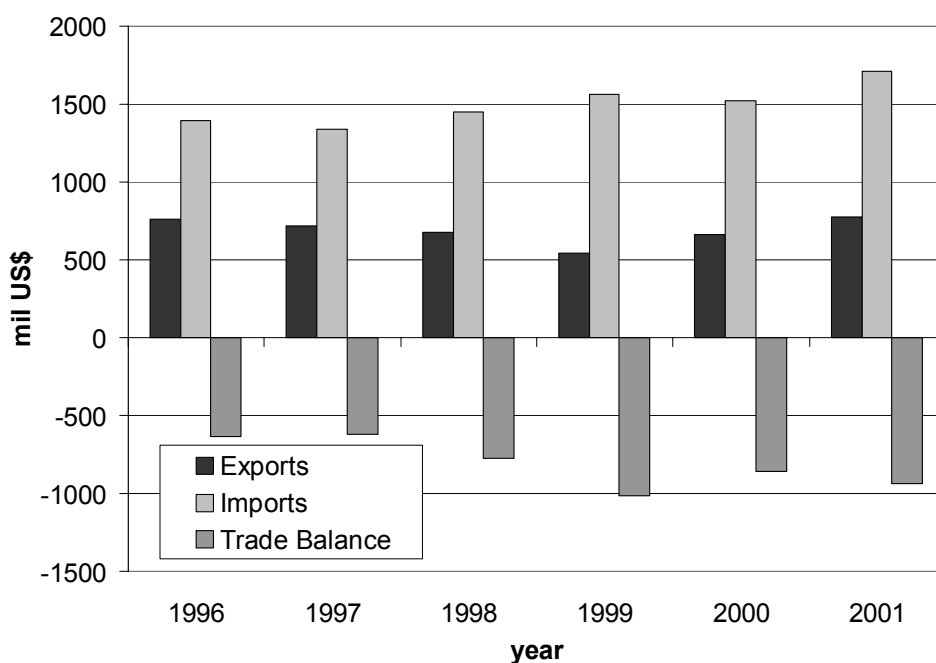
### 4.3.1 Structure and Composition of External Trade

Graph 1 shows the volume of Tanzania's exports and imports for the past 5 years. Not surprisingly for an LDC, the trade balance is negative throughout the period observed. The worst year during this

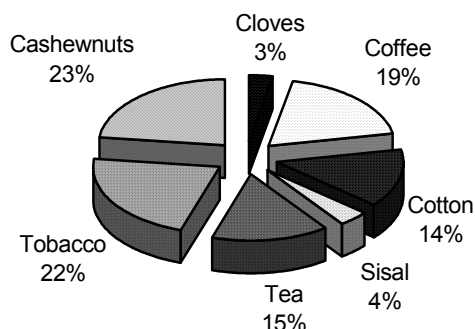
period was 1999, when the value of exports amounted to roughly one third of the value of total imports, resulting in a trade balance deficit of just over 1 billion US \$. Exports have picked up over the last three years, after a continuous decline in previous years, but by far not enough to make up for what seems to be a steady positive trend in imports, leading to an increasingly negative trade balance. A further reduction of import tariffs is likely to exacerbate this already worrying situation, at least in the short run.

Tanzania's traditional exports are coffee, cotton, sisal, tea, tobacco and raw cashew nuts (see Graph 2). Its non-traditional exports include petroleum products, gold, other minerals and manufactured goods (SADC 2001); (see Graph 3). The structure of exports has substantially changed in recent years as non-traditional exports play an increasingly important role in Tanzania's external trade. As can

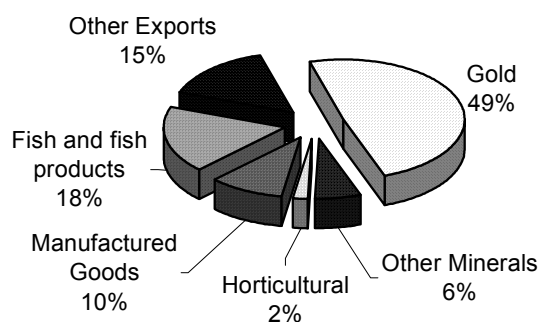
**Graph 1: Tanzania's Trade Balance 1996–2001**



Source: International Monetary Fund

**Graph 2: Structure of Traditional Exports (Nov–Oct 01/02)**

Source: SADC (2001)

**Graph 3: Structure of non-Traditional Exports (Nov–Oct 01/02)**

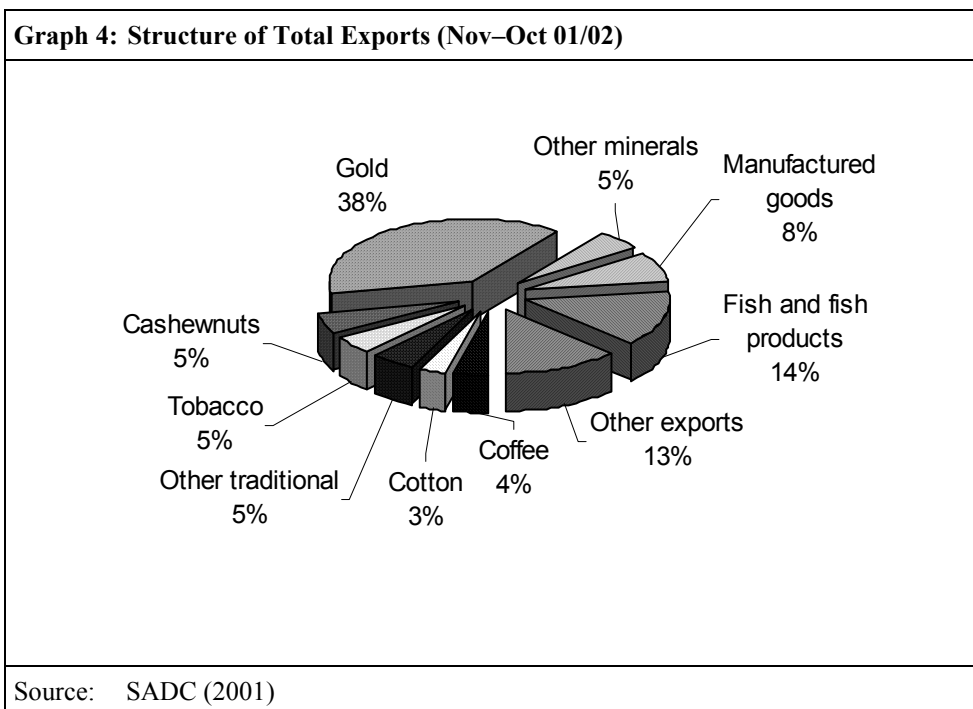
Source: SADC (2001)

be seen from Graph 4 by the end of 2002 the share of non-traditional exports had increased to 77.9 % of total exports, while traditional exports accounted for only 22.1 %, down from 60.0 % in 1998 (Bank of Tanzania 2002). This increase is mainly due to large-scale investment into the mining sector, which in spite of low prices in the world market recently has made gold the most important export commodity, accounting for 38 % of total export value in fiscal year 2001/02. At the same time, traditional exports have declined both as a share of total ex-

ports and with regard to their total value, mainly because of low world market prices.

Table 5 shows the aggregate composition of Tanzania's imports by major commodity groups with the respective nominal tariff rates. As depicted in Graph 5, Tanzania relies on a wide range of imports. Capital goods such as machinery, transportation equipment, and industrial raw materials, and consumer goods constitute the major portion of





**Table 5: Imports by Main Product Categories in 2000**

Product Category	Millions of TSh	Share in %	Non-EAC Tariff Rate
Capital Goods	237,668	40	0 % / 5 % / 10 %
Intermediate Goods	119,302	20	10 % / 15 %
Consumer Goods	243,395	40	25 %
<b>Total</b>	<b>600,365</b>	<b>100</b>	–

Source: Bank of Tanzania 2002

imported products. However, because of a decrease in domestic agricultural production attributable to climatic conditions, food and foodstuffs imports have increased sharply during the past few years.

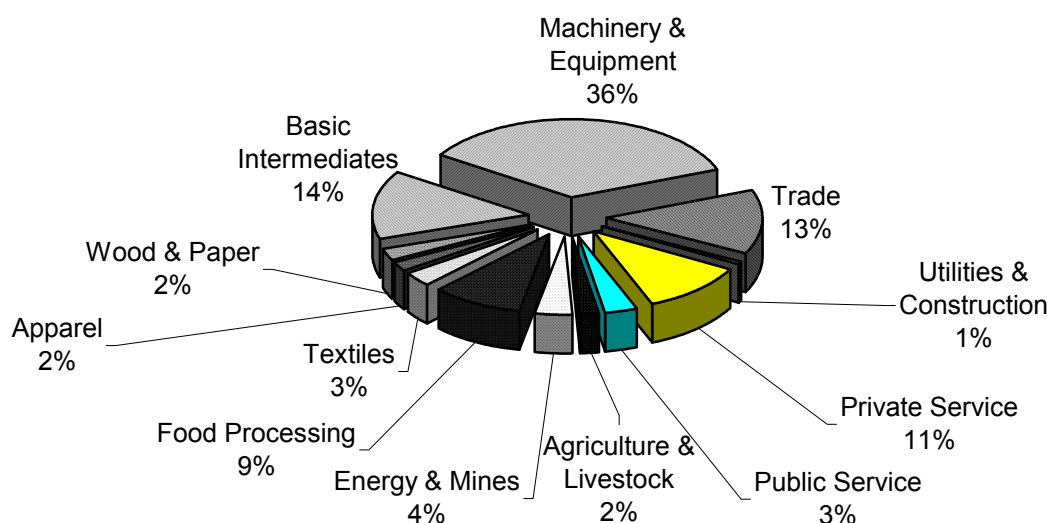
### 4.3.2 Implications of EPAs for Tanzanian Producers

The elimination of trade barriers is in principle expected to result in efficiency gains for members of an FTA due to a more effective division of labour and resulting trade creation. However, for these gains to materialise, a minimum degree of differentiation between the member states' economies is indispensable. As far as regional trading partners in

sub-Saharan Africa are concerned, there is only limited scope for such differentiation or complementarities. Most of these countries share similar economic structures resulting in patterns of trade flows largely biased towards advanced countries (Lyakurwa et al. 2001:6).

Tanzania's intra-regional trade with other EAC members (and SADC, for that matter) is low, as is the case for most sub-Saharan African countries (Lyakurwa et al. 2001:19; Ng and Yeats 2000).<sup>26</sup> By contrast, trade with the EU offers in principle a

<sup>26</sup> Kenya and Uganda together accounted for only 6.8 % of Tanzanian imports in 2001/02, and trade with SADC amounted to less than 5 % between 2000 and 2002.

**Graph 5: Structure of Imports**

Source: SADC (2001)

larger scope of complementarity and diversification in the case of further trade liberalisation. However, trade openness towards the EU also bears a much larger risk of trade diversion, i.e. goods that are currently imported from third countries might be replaced by goods from the EU due to tariff elimination – and not necessarily because of higher efficiency of European producers. At the same time, the benefits for consumers of EU imports as well as for producers, who use imported intermediates in their production, might be considerable.

Views on whether trade creation will be beneficial, threatening or of no relevance at all for Tanzanian producers differ widely among Tanzanian stakeholders. In order to assess the potential risks of regional integration for Tanzania, our approach is as follows. Recurring once more to our estimates on trade diversion and creation discussed above, we identify industries for which the expected trade creation from partner countries is largest due to tariff elimination in Tanzania, and suggest that this reflects a threat due to increased competition for Tanzanian producers.

Opportunities for Tanzanian exporters, by contrast, are identified by means of revealed comparative advantage (RCA) indices calculated for current trade flows between Tanzania and the regional trading partners as well as for trade with the EU. In each section we then examine in more detail a selection of agricultural products that are particularly relevant to Tanzania, either economically or for domestic food security reasons. Calculation of RCA indices also gives an indication of the probability that individual industries will relocate from one country (with a lower comparative advantage in that industry) to the other once an FTA is implemented (World Bank 2000:53).

### **Risks of Enhanced Regional Integration?**

Even where there is some degree of differentiation, as in the case of Kenya, with its relatively well developed industrial sector on the one side and the agriculturally dominated economies of Tanzania and Uganda on the other, there appears to be very limited complementarity between the member states' patterns of specialisation and trade. The overall

volume of regional trade creation is relatively small, according to our estimates, with total imports from the region increasing by roughly 2.2 %. This result is in line with what one would expect in a region as little diversified as East Africa and suggests that the economic risks – but also the opportunities – of East African regional integration are rather minor for Tanzania.

A more detailed look at various relevant product groups reveals that within the manufacturing sector the industry in which regional trade creation is most significant appears to be the textiles and clothing industry. Out of 49 products experiencing an increase in imports from regional partners by 10 or more percentage points, four are basic textile products such as printed or coloured woven fabrics. These compete directly with products from domestic textile mills.

In agriculture, the sub-sector most adversely affected seems to be animal husbandry. Again, four out of 49 products with trade creation of more than 10 % are either live sheep or mutton or bovine animals. As food security is a major concern in LDCs like Tanzania, we take a closer look at a selection of starch staples commonly traded in the region, such as wheat, maize, and rice. We find trade creation to be of a significant magnitude (10 %) only for durum wheat, which, however, constitutes no more than a negligible share of total imports of starch staples. For all other products in the selected groups of products, regional trade creation amounts to less than 3 %. Our conclusion is, therefore, that regional integration does not pose a major risk for Tanzania's food security based on domestic production.

### **Risks of Introducing Reciprocity with the EU**

As for reciprocal trade liberalisation vis-à-vis the EU, here trade creation is more significant than in the case of regional integration. This is the expected result and it is presumably due to two reasons: First, internal tariffs within the EAC are already lower than towards the rest of the world, including the EU; the elimination of import tariffs on EU products will therefore imply a much larger price change than in

the case of regional trade liberalisation. Second, there is a much stronger complementarity between the European and the Tanzanian production structure, with European producers being in a position to raise trade volumes more easily in a number of commodities in the case of tariff elimination.

From the estimated trade creation accruing to the establishment of an EU-EAC EPA, we conclude that, once more, the textiles industry may suffer most from increased competition through cheaper imports. Of 22 items experiencing an increase of trade volumes with the EU of more than 10 %, 11 are textile products. This, again, is also due to the fact that current tariff protection is among the highest in these industries.

In the agricultural sector, we did not find any significant effect in any sub-sector, and estimated trade creation was found to be surprisingly low. As far as food security is concerned, we also find no evidence for an immanent threat in form of substantially increased import competition in staple food products.

In view of these results, however, it seems appropriate to highlight some of the weaknesses of the approach taken. The fact that low or no trade creation is estimated in particularly sensitive sectors, such as for instance staple foods, may be due to one or more of the following reasons. Either tariffs are already low or zero, and thus tariff elimination will not have a major impact on import prices and consequently do not lead to any further effect in our calculation. However, prices and production structures as revealed by actual trade flows may already be distorted to an extent that cannot be calculated in the framework of the methodology used here. Second, some products may simply not be imported prior to trade liberalisation, and thus no trade creation is calculated. The latter could be the case for products for which an import ban is in effect. In this case, the method of identifying risks and opportunities by examining the relevant trade creation cannot produce satisfactory results.

#### Box 4: Risks and Opportunities from the Perspective of Tanzanian Manufacturers

Tanzanian businesspeople are surprisingly self-confident with regard to the competitiveness of their companies in a regional framework. Most expect the EAC customs union to be beneficial to the Tanzanian industry. This perception is mainly due to the fact that the negotiations – besides the elimination of internal tariffs and the establishment of a common external tariff – also cover NTBs, which most Tanzanian producers see as the main obstacle to exports to Kenya. However, the same producers expect protection in the form of suspended tariffs on selected items (like the traditional textile products Kanga and Kitenge) to be maintained, claiming that without them they would not be able to compete with Kenyan suppliers. Similar views are expressed in the tea packing industry with respect to the ban on tea imports. Other industrialists believe they will benefit from the elimination of internal tariffs in the EAC, because cheaper inputs will then be available. For example, one food-processing and canning operation in Arusha which receives its tin cans via Mombasa, and for the time being has to pay Kenyan as well as Tanzanian import duty on these, hopes it will become more competitive in the regional market once internal tariffs are abandoned.

Views on liberalisation towards the EU are more sceptical but also diverse in nature. One large supplier of car parts owned by a multinational company expects that the European mother would most probably close down its Tanzanian production facilities once it could supply the East African market duty-free from Europe. By contrast, there are producers from other industries that hope to benefit from cheaper inputs, claiming that European producers are no threat to their business, because they do not offer products tailored for the specific needs of the African market. Finally, there are companies that hope to be able to benefit from improved market access to and, in particular, better information on market requirements in Europe. These include processors and packers of fruit, juice and cashew nuts as well as textile mills. Particularly interesting export opportunities for Tanzanian producers are seen in increasing European demand for organic products.

### Opportunities of Regional Integration

In order to identify whether Tanzania may benefit from regional integration through improved export opportunities in particular product groups, we calculate indices of revealed comparative advantage (RCAs) for both regional trade and trade with the EU in product groups at the 4-digit level of the HS code.<sup>27</sup> The underlying assumption of this approach is that once trade barriers are dismantled from a competitiveness point of view, Tanzania will be in a

position to expand its trade vis-à-vis its main trading partners in those sectors and commodity groups where a comparative advantage is already revealed by the current pattern of trade flows. Actual trade potential, however, depends on a number of factors other than just a high RCA. One limiting factor of this approach then lies in the implicit assumption that there are no capacity constraints impeding export expansion.

A ranking of all RCAs of Tanzanian products exported to the region shows that only one fifth have a positive RCA, predominantly originating from agricultural production. As there is a small overlap of current export and import structures vis-à-vis Kenya, a small trade potential may be inferred from this estimate. No significant comparative advantage can be observed, however, for most of Tanzania's manufactured products. Tanzania's textiles sector in particular has low or even negative RCAs, implying a low potential for trade expansion in the region resulting from further trade liberalisation. The main reason for this finding may be attributed to Tanzania's relatively high cost of production, specifically relating to energy, telecommunication and transport costs.

27 RCAs were calculated for the present study using the formula  $(X_j - M_j) / (X_j + M_j)$ , where  $X_j$  denotes exports of products within group  $j$  to the region, and  $M_j$  denotes imports of products within group  $j$  from the region. RCA calculation of this type results in indices ranging between 1 and -1. RCAs in the vicinity of 1 show a comparative advantage, whereas RCAs in the vicinity of -1 show a comparative disadvantage for products produced in Tanzania. The calculation was done at the 4-digit HS-level and for those headings for which we derive Tanzania's RCAs towards the EAC and EU partners of 0.5 or higher. It must be noted that any specific value of this measure is consistent with any volume of trade (Greenaway and Milner 1993:186). For matters of convenience we have not included the tables in this report but they are available on request from the authors

As regards export opportunities created by the regional integration process, NTBs in the form of “informal movement fees,” administration of sanitary and phytosanitary certification and onerous customs procedures in general seem to be much more a hindrance to agricultural regional trade than tariffs (EAC 2002). This view has been confirmed by personal communication with producers as well as by experts of the respective institutions such as the Board of External Trade and the Tanzanian Bureau of Standards (see Box 4).

### **Opportunities of Trade Liberalisation with the EU**

Since Tanzania already enjoys tariff-free market access to the EU, opportunities from an EPA will mainly derive from the elimination of NTBs and increased investment in Tanzania’s export sector. Once more, we calculate RCAs to identify those sectors that might benefit most from such steps.

Most of Tanzania’s main traditional export commodities such as cashews, coffee, cotton, tobacco, sisal, and tea display the expected high RCA values with respect to the EU. This result is, however, mainly explained by the methodology applied: RCAs are naturally high if one of two trading partners is the sole exporter of the respective product. The EU does not produce coffee and Tanzania has an import ban on coffee; thus trade flows only occur in one direction, resulting in a high RCA value even though turnover of coffee production and export volume continuously decrease.<sup>28</sup> Moreover, the indices can be high irrespective of the volume of trade actually taking place. Hence, very small trade flows irrelevant to total trade can produce high RCAs.

However, a number of important products show promising results, such as calculations for the tex-

tiles sector and its raw materials (cotton, hemp, sisal), a number of horticultural products, cut flowers, and various fish products. They result in RCAs of 0.9 and above, indicating that additional trade potential could be realised if remaining trade barriers were eliminated, and supply-side constraints were overcome that currently impede expansion of production and exports.

Whether additional opportunities for Tanzanian producers will result from an EPA will therefore depend to some extent on whether any measures to improve access to the EU’s markets are included in the agreement. Since under the EBA initiative Tanzanian products already have duty- and quota-free market access to the EU, the issue to be addressed in this context is mainly NTBs. The rules of origin and sanitary and the phytosanitary standards that the EU applies to some of these industries pose particular problems.

The rules of origin currently applied by the EU are a particular problem for producers in the textiles and clothing industries. For instance, the EU requires for cotton clothing that the manufacturing process must ‘manufacture from yarn,’ implying that the yarn must be sourced locally and that imported cotton fabric cannot be used (Brenton 2003:3). Even though Tanzania is in the comfortable position to grow cotton, for a number of processes this is not the most efficient and appropriate input source. The production of yarn and fabric are bottlenecks. However, if cotton, yarn or fabric are imported from other countries external to the ACP, Tanzania will lose its preferential market access and have to export under MFN conditions to the EU market.

As for the manufacturing sector as a whole, a number of observers and private sector representatives consider measures to attract European investors, secure improved access to export finance as well as to provide better information on market requirements in Europe equally important to further improving market access in terms of tariffs and NTBs (see Box 4). Also, the extent to which the economy could benefit from larger markets appears rather limited, since many of the domestic manufacturers even lack the capacity to serve their local, let alone national and international, markets.

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28 Consequently, even though coffee has experienced severe price drops on international markets, a RCA of 1 is derived for Tanzania, a country with one of the most suitable coffee production environments in the world, because it has undertaken substantial efforts to diversify away from coffee and to food crop production.

Tanzanian producers and exporters of agricultural products still have considerable difficulties in fulfilling European market requirements in terms of quality standards, sanitary and phytosanitary standards (SPS), and health and consumer protection standards and their respective certification. Putting into place adequate mechanisms and incentives to ensure compliance with international standards should be a major concern of stakeholders in the agricultural sector. Our findings moreover confirm the view that the sector still faces serious production constraints that limit efficiency, output and quality of production, and consequently its ability to seize new export opportunities.

#### 4.4 Social Implications

The social implications of trade liberalisation may be manifold, depending on the various transmission channels, the policies and institutional structures in place and the time allowed for the adjustment process. In the following the most pertinent issues in the case of Tanzania are identified, i.e. the social implications of a potential revenue loss and adjustment costs to be faced by the main economic sectors. The findings in this section draw both on the quantitative analysis presented above and interviews with Tanzanian stakeholders, particularly with private sector representatives.

##### Social Implications of Revenue Loss

As far as social implications of the fiscal impact of an EPA are concerned – in addition to the overall revenue loss discussed above – both potential measures to compensate for this and changes on the expenditure side need to be taken into consideration.

On the revenue side, the attempt to compensate for a loss of revenue through alternative sources inevitably has distributional consequences. Their nature depends on which sources are chosen. The remedy commonly proposed whenever revenue losses due to trade liberalisation are addressed is to broaden the tax base, preferably by introducing a generally applicable VAT. The main appeal of the VAT is that it causes relatively small distortions in the economy.

However, at a rate of 20 %, the existing VAT in Tanzania is already comparatively high; indeed is even the highest in the region. Consequently, this is not an instrument likely to offer much more room to improve the treasury's accounts.<sup>29</sup>

Most other fiscal instruments are more problematic and quite often lead to an inefficient allocation of resources in the economy and (sometimes unwarranted) re-distributional effects on incomes between different segments of the economy. In the case of Tanzania, special caution should be used to avoid the possibility that additional taxes are imposed exclusively on potentially less organised groups such as agricultural smallholders or informal micro-businesses in the larger towns. As in most LDCs with an orientation towards economic development driven by import substitution and/or export promotion, the Tanzanian tax system is currently already heavily biased in favour of the urban population.

The same argument applies if alternative sources of revenue are not found or do not suffice to make up for the revenue loss incurred. In this case, the only fiscally sustainable way out would be to resort to cuts on the expenditure side. Substantial cuts in public expenditure would be highly disputable from a social point of view in the case of Tanzania. The country has endorsed serious steps towards poverty reduction and increased social sector spending as a share of total expenditure by a considerable amount in the past (OECD/AfDB 2003:206). Budget constraints already put these achievements at risk. Consequently, there is little room for manoeuvre on the expenditure side without running the risk of negatively affecting social sector expenditure.

##### Social Implications of Economic Adjustment

The economic costs and benefits that may arise from establishing an FTA with the EU will more-

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29 Although it is true that Tanzania has an extensive exemption regime which provides for many exemptions from payment of the VAT as well, our argumentation above suggests that challenging these exemptions might not be an easy task.

over have direct social implications. Again, it must be ensured that the most vulnerable groups do not have to bear the costs of economic adjustment following an elimination of import tariffs towards the EU, and that they are able to fully participate in the benefits. New export opportunities may also benefit the poor. Trade policy affects the poor in various ways:

- In their capacity as producers, they are affected by price changes for the inputs they use as well as for the products they sell. Consequently, trade liberalisation resulting in cheaper imports as well as in potentially increased demand opportunities might at the same time destroy and generate employment, possibly creating entirely new forms of jobs.
- As consumers, the poor may benefit from lower prices for the goods they buy, be they imported or domestically produced.

80 % of Tanzania's population are employed in the agricultural sector. Accordingly, most of Tanzania's poor are farmers or live in rural areas. Consequently, even though we have found no evidence that increased competition in the wake of regional integration and trade liberalisation toward the EU would be insurmountable for Tanzania's agricultural sector, it seems indispensable that special attention be paid to identifying necessary safeguards in this particular sector of the economy – even more so as food insecurity must still be regarded as the major concern of the rural poor in Tanzania (OECD/AfDB 2002:288).

For instance, domestically produced crops might be substituted with cheaper imports of staple foods over the medium to long term. and this could result in changes in consumption patterns, as is already the case in large parts of West Africa. This will affect the incomes of producers of local crops. Moreover, increasing dependence on food imports renders poor consumers more vulnerable to price or exchange-rate shocks. Analyses of the social implications of EPAs therefore must take into account not only the direct effects of tariff elimination but also potentially medium- to long-term changes of production and consumption patterns.

As far as the manufacturing sector is concerned, different concerns arise. While on the one hand we found that the threat from regional and European competitors is more immanent in the manufacturing sector (especially in textiles) than it is in agriculture, there were on the other hand also indications that the manufacturing sector may be better prepared to seize increased opportunities. In addition, this sector is much better represented at the political level than the agricultural sector. Given the relatively high level of protection currently enjoyed by manufacturing industries, adjustment costs to raise productivity and competitiveness to the necessary levels will, however, be substantial.

Negative social implications can be mitigated by longer – yet firmly determined – transition periods that could be envisaged under EPAs, as well as by the lower costs of imported inputs. While efficiency gains should in principle benefit all consumers in Tanzania, further research is needed to assess the distributional consequences of shifts in the production structure. Furthermore, in addition to firm-level adjustment, competitiveness of the manufacturing sector could be raised substantially by lowering the high costs of utilities in Tanzania, including electricity, water, transport and telecommunications.

#### 4.5 Recommendations

Our findings indicate that the opportunities and risks arising from the conclusion of an EPA for Tanzania are manifold. None of the proposed opportunities identified will materialise automatically; they will instead have to be actively seized by Tanzania's stakeholders. Similarly, measures need to be taken to mitigate the identified risks. Hence, Tanzania needs to formulate an effective and coherent negotiation strategy, including measures to be undertaken domestically that will enable the country to make optimal use of the new trading arrangements. With regard to the economic implications of EPAs, we therefore recommend the following:

1. The Tanzanian government should as soon as possible commission an impact study in accordance with the terms of reference provided by the ACP secretariat. This study should examine the

fiscal, economic, and social impact of an EPA on Tanzania in a thorough and comprehensive manner. In addition, this study should also take the fiscal and economic implications of the regional dimension of EPAs explicitly into account.

2. Any conclusions drawn and recommendations made in this study should be based on economic and political realities in Tanzania. In particular, estimates of the fiscal impact of an EPA should take tax exemptions into explicit account. Recommendations based on these estimates must not overlook the political economy underlying the exemption regime in place.
3. Based on the results of the study, Tanzania should prepare for a loss of public revenue due to tariff elimination. Feasible measures to compensate for this revenue loss need to be identified, i.e. systematic efforts must be made to find alternative sources of revenue.
4. Particular attention should be paid to potential risks and opportunities in the agricultural sector, and their social implications. In addition to short term effects of tariff elimination vis-à-vis the EU, medium- to long-term implications for trade and consumption patterns need to be taken into account. Defining safeguard measures will be of particular concern with a view to European subsidies still in place.
5. For the agricultural sector, it will moreover be of special importance that national policies are adapted to the actual needs of producers in the various sub-sectors, and implemented accordingly. No trade strategy can substitute for the institutional and policy deficits currently burdening the country.
6. The same applies for Tanzania's incipient industrial sector. There is still a need to create an appropriate business environment which allows the manufacturing sector to become competitive in a global economy. However, the sector should not receive excessive protection at the cost of domestic consumers; it needs instead to

be able to adjust to efficiency and quality requirements during a defined period of time.

## **5 Preparation of EPA Negotiations: The Multilateral and National Level**

The beginning of formal negotiations at an all-ACP level in September 2002 immediately revealed unequal bargaining powers between the EU and the ACP group. It became apparent that there is a lack of co-ordination among the ACP states, mainly due to weaknesses in their organisational structure and because of the heterogeneity of interests. In addition, many ACP states, like Tanzania, lack experience and the capacity to formulate their national interests in trade issues. However, one condition required to be in a position to seize the opportunities associated with the negotiations of the envisaged trade agreements is for the countries of the ACP group to formulate their key interests with regard to the national and regional level and defend them in multilateral negotiations.

The present chapter first outlines the current state of negotiations of EPAs at the multilateral level and the organisational structure of both contracting parties, highlighting organisational deficiencies at the EU-ACP level of negotiations. Second, the chapter describes the current state of preparations at the national level in Tanzania. It analyses ministerial responsibilities and identifies shortcomings in Tanzania's formulation of trade policy. Special attention is given to the involvement of non-state actors, as stipulated in the Cotonou Agreement. The chapter concludes with a discussion of how to strengthen Tanzania's trade capacity and makes recommendations on how to prepare EPA negotiations more effectively at the national level.

### **5.1 Preparations for EPA Negotiations at the Multilateral Level**

The negotiations between the EU and the ACP countries started at an all-ACP level in September 2002. According to the European Commission's



rationale, EPAs should be negotiated on a regional level. The contracting parties therefore have agreed to divide the negotiation into two phases. During phase I, discussions of a more general nature will take place at an all-ACP level. In phase II, envisaged to start in September 2003, the EU will enter into negotiations with regional integration initiatives. This is, in view of the situation in East Africa, an ambitious goal. But the European Commission has already signalled, that – if justified – phase I could be extended.

The following timetable is currently envisaged by the contracting parties:

From Sept. 2003: Launch of negotiations of EPAs with regional groupings (phase II)

2005: Exploration of alternative possibilities for non-LDCs

2006: Formal and comprehensive review of progress in negotiations

31<sup>st</sup> December 2007: Phase-out of waiver allowing non-reciprocal trade preferences

1<sup>st</sup> January 2008: Entry into force of any EPA which may have been concluded

2008-2018/2020: Implementation of EPAs and transition to fully fledged FTAs

2018/2020: Entry into force of WTO-compatible FTAs

### 5.1.1 The EU's Negotiation Structure

At all levels, the EPA negotiations will be conducted by the European Commission, which was given the mandate to negotiate by the Member

States of the EU,<sup>30</sup> i.e. at the ministerial, the ambassadorial and the technical level.<sup>31</sup> It was moreover decided that the negotiation of EPAs falls within the responsibility of DG Trade (and not DG Development), a fact which shows that for the Commission EPAs are first of all trade agreements, although with a development component.

The EU is a strong and experienced negotiation partner. It is a supranational organisation that speaks with one voice during negotiations, thereby representing the currently fifteen and the later 25 member states. Thus, the position of the European Commission is always the outcome of a co-ordination and/or voting process between the European Commission and its member states and within the European Commission. This has a twofold effect: On the one hand, it limits the scope of negotiation options; on the other hand, it clearly adds to the European Commission's bargaining power.

It should be noted that the EU's enlargement in 2004 will have an impact on the negotiations with the ACP states, as the acceding countries are countries with a high dependence on agriculture. Thus, the EU might become even more reluctant to liberalise the agricultural sector, a sector where the ACP countries are supposed to have comparative advantage. Furthermore, the co-ordination process within the EU is very likely to become more complex and difficult as a result of the need to establish new decision-making procedures, to adapt to structural problems and to review major policies, especially the CAP.

30 The mandate was necessary because according to the treaty establishing the European Community, the EC has been given an exclusive power only in the area of common commercial policy; Article 133 of the Treaty of Amsterdam. The envisaged EPAs will exceed this competence in that they will not be pure trade agreements but will also – amongst other things – regulate development and investment matters.

31 At the ministerial level, the EU delegation will be headed by Trade Commissioner Pascal Lamy, who will be accompanied by other commissioners as necessary. At the ambassadorial level, the Director of DG Trade will head the EU delegation, accompanied by senior officers from various Directorates General.

### 5.1.2 The ACP's Negotiation Structure

The ACP side also foresees a ministerial, ambassadorial and technical level. But its organisation is more complex, mainly because of the large number of states – currently 78 – that have to be represented at the different levels. At the ministerial and ambassadorial level, negotiating groups headed by so-called troikas had to be established to ensure that all ACP regions are adequately represented.<sup>32</sup> As a result of this complexity, the beginning of negotiations had to be delayed until the ACP side had set up its structure.

At the ministerial level, the ACP Council of Ministers will be the decision-making organ. It is responsible for adopting negotiating positions and approving all outcomes of the negotiations.

At the ambassadorial level, the Committee of Ambassadors (COA) will prepare the negotiations for decisions at the ministerial level. At the technical level, it is foreseen that the negotiating groups will prepare technical briefs and submit them to the COA for review, discussion and final approval before these groups meet with the EU side.<sup>33</sup> Outcomes of negotiations at this level are again subject to COA endorsement. At the next stage, joint ACP-EU ambassadorial level negotiations will be convened to approve the work done by the negotiating groups, discuss cross-cutting issues and finalise preparations for the ministerial level meetings.

Compared to the EU, the ACP side is a weak negotiation partner, and decision-making processes are bound to be slow due to the complex negotiation structure. One reason for the creation of such a complex structure with working groups on three

levels is the absence of a common foreign trade policy on the ACP side and the apparent wish of the national governments to keep tight control over the negotiations. So far, the regional organisations have not received a mandate, since none of the EPA groupings that are likely to form the EPA configuration are currently a customs union, let alone have a common trade policy. This makes it crucial for the national governments to strengthen their trade capacity in order to be represented in an effective manner at all levels of the negotiation process and to manage, in addition, the necessary coordination among themselves.

## 5.2 Preparations of the Negotiations at the National Level

Conducting multilateral trade negotiations presupposes that key interests with regard to trade policy have been formulated at the national level. The next section therefore examines the process of trade policy formulation in Tanzania. The definition of trade interests requires:

- structures and procedures to support the definition of interests;
- a clear distribution of roles and responsibilities between ministries;
- mechanisms to involve all relevant stakeholders, including non-state actors;
- allocation of the resources needed to implement policies; and
- analytical capacity.
- As trade policy touches upon a variety of issues other key ministries typically involved in trade policy formulation – in addition to the Ministry of Trade – are (Solignac Lecomte 2001:13);
- the Ministry of Finance because of the fiscal implications of tariff policies;

32 These 'troikas' consist of one spokesperson and two alternate spokespersons representing each of the ACP regions.

33 Technical preparations are led by the ACP Secretariat with the assistance of an Advisory Group of High Level Trade Experts, consisting of experts representing the regional economic integration organisations and officials of collaborating institutions. The Advisory Group of High Level Trade Experts has not yet started its work due to differences between the ACP Council of Ministers and the ACP Secretariat concerning responsibilities and tasks.

- the Ministry of Foreign Affairs because of its responsibility for political relations with trading partners;
- the Ministry of Agriculture and other line ministries because of sectoral implications of trade.

The following section first outlines the current state of preparations of EPA negotiations and, second, analyses how trade policy formulation is carried out by giving a short overview of the responsibilities of the ministries involved in trade policy formulation in Tanzania.

### 5.2.1 The Current State of Preparations of the Negotiations in Tanzania

Concrete preparations for the negotiations in Tanzania started only in January 2003. EPAs are not a priority on the policy agenda. One reason for this is that at the moment Tanzania's primary concern regarding trade is the establishment of the East African Customs Union, which is supposed to enter into force in November 2003. Also, the Tanzanian government needed to reorganise responsibilities within the government with regard to the EPA negotiations, since the former structure of co-operation with the EU did not reflect trade policy issues. The Ministry of Finance (MOF) initiated a first meeting on EPAs at the technical level in January 2003. The outcome of the meeting was to recommend (Ministry of Finance 2003):

- that the Ministry of Industry and Trade (MIT) be made the lead ministry to co-ordinate EPAs. Considering the limited capacity of MIT, it was recommended that the MOF should work in close consultation with the MIT and provide secretarial services;
- that the MOF should take the initiative to immediately form a task force to provide technical back-up on EPA negotiations;
- that an impact study be commissioned to establish baselines and modalities for negotiations.

The follow-up process to this meeting was, however, sluggish. The envisaged task force had not been appointed by the time of writing, nor have the terms of reference for the impact study been finalised or the respective request for funding processed. The regional dimension of EPAs was not taken into consideration, according to the draft terms of reference, which means that the implications of the current overlap between SADC and EAC for Tanzania's EPA position will not be taken into consideration. This would be a serious shortcoming of any such impact study.

### 5.2.2 Structure for the Preparation of the Negotiations in Tanzania: Roles and Responsibilities

Difficulties encountered in the preparations for EPA negotiations result from a fragmentation and lack of clarity of responsibilities in the formulation of trade policy in general. Trade policy issues have not been given a high priority in the past years, a fact reflected by the rather weak position of the Ministry of Industry and Trade within the government.

In addition, there is no permanent intra-governmental committee to consult on trade policy issues and to act as a facilitator for co-ordination of interdependent issues. This leads to an ad hoc approach to inter-ministerial consultation, which moreover undermines the effectiveness of participation of the line ministries, particularly in reporting on the sectoral implications of policy proposals and negotiation strategies. The same goes for NSAs, as there are no mechanisms established to involve them: There is neither a regular reporting system nor a consultation forum.

**Ministry of Finance (MOF):** MOF holds the position of EDF Authorising Ministry, because the allocation of EDF funds was formerly seen as the major element in ACP – EU relations. As a budgetary issue it fell within the responsibility of the MOF. With EPAs on the agenda, the major focus has shifted to trade issues and this calls for the Ministry of Trade and Industry to play a greater role. MOF is mainly concerned with revenue collection.

**Ministry of Industry and Trade (MIT):** MIT has formally been declared the lead Ministry of trade policy formulation, exemplified by the National Trade Strategy. But while carrying lead responsibility on the WTO, it does not lead on regional trade agreements and only now is supposed to be given the role of co-ordinating EPA negotiations in collaboration with the MOF. Assigning lead responsibility on WTO issues and EPA issues to one single Ministry, i.e. MIT, would facilitate the requisite co-ordination in multilateral trade matters in the future.

However, the capacity of MIT to fulfil its mandate is currently very limited. Work practices and technical skills are still constrained by MIT's former role of managing and administering government-monopolised trade under a socialist economic system. Although MIT was appointed to be the lead authority for trade policy formulation, the division of labour between MIT and the Office of the President, Planning and Privatisation on trade policy issues is not clear-cut, as the latter is responsible for trade policy at the macro level. In addition, although the first meeting to prepare EPA negotiations recommended that MIT take the lead for co-ordination of EPA issues, it also recommended that MOF should appoint the task force for EPA negotiations.

**Ministry of Foreign Affairs and International Co-operation (MFAIC):** The MFAIC is responsible for regional integration initiatives, namely the EAC and SADC. At present, EAC and SADC do not fall within the responsibility of one single department: EAC trade issues are addressed in the Department for East Africa and the Department for Multilateral Co-operation deals with SADC and WTO issues. According to an internal communication, the departments are set to become one department with responsibility for "Regional co-operation." Notwithstanding MFAIC's lead responsibility on economic and political aspects of the regional integration processes (EAC and SADC), the EAC Secretariat concurs with MOF on tariff matters, leading to a bias towards revenue considerations in developing national positions.

**Ministry for Agriculture and Food Security (MAFS):** Considering that the agricultural sector contributes the largest share of foreign exchange

earnings in Tanzania, we were surprised to find out that the Ministry of Agriculture and Food Security only plays a minor role regarding trade policy. Currently, this Ministry deals with WTO, AGOA, EBA and SADC issues, but there is no particular structure for Cottonou or EPAs. EPAs will probably concern agricultural marketing policies, which fall within the responsibility of the newly created Ministry of Cooperatives and Marketing. To our knowledge, this Ministry does not at present contribute to international trade policy formulation.

### 5.2.3 The Way Forward: A Task Force for EPA Negotiations

As was discussed above, responsibilities between Ministries in the formulation and negotiation of trade policies are fragmented and there is no permanent intra-governmental committee to consult on trade policy issues. With regard to the preparations of EPA negotiations, it is therefore essential to establish mechanisms to involve all line ministries, to inform all relevant stakeholders, including non-state actors, and to establish a forum for consultation. We therefore support the recommendation made by the Draft Institutional Review of the Tanzania Trade and Poverty Programme (TTPP) to establish a Ministerial Committee on Trade Policy.<sup>34</sup>

We furthermore propose:

- To establish a task force consisting of representatives from the MIT, MOF, MFAIC, MAFS and POPP under the chairmanship of MIT. The task force should be small to make it work effectively. Each institution should be represented by two members: the Permanent Secretary and a

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<sup>34</sup> The standing Ministerial Committee on Trade Policy is supposed to co-ordinate action on all international trade issues. It was recommended that it should consist of ministers from MFAIC, MOF, Ministry of Agriculture and Food Security, a representative of the Tanzania Revenue Authority, and other ministries and agencies as required. The task force that we are proposing could be seen as a Sub-Committee of this Ministerial Committee. Other Sub-Committees on other trade negotiation settings like the WTO could be created.

senior staff person to minimise the risk of staff turnover and to ensure continuity in the preparation process.

- To give a clear mandate to the task force to coordinate the preparations for negotiations and to develop a negotiation strategy. The task force should be in a position to establish working groups dealing with specific issues. These working groups should consist of senior officials from the Ministries, Government Agencies and NSAs concerned. Such multi-agency working groups would ensure that the interests of various stakeholders are taken into due account.<sup>35</sup>
- To establish a reporting mechanism between the task force and all line ministries and NSAs to inform them about the work of the task force (also see 5.3 below).
- To nominate within each ministry staff positions as contact points for EPA issues to assign clear responsibilities for EPAs within each ministry. The contact point would be responsible for the dissemination of information within its ministry. In the case of the five ministries represented in the task force, the contact point should be a member of the task force.
- To give all line ministries and non-state actors a possibility to discuss and comment on the proposals made by the task force by establishing a monthly consultation forum to be organised by the chair of the task force.

### 5.3 Involvement of Non-State Actors in the Preparation of Negotiations

Involvement of NSAs within the Cotonou framework and especially in EPA negotiations is an ambitious goal. As discussed above, the new trade re-

gime will affect the income and thereby the welfare of wide parts of society and there should be more transparency and more active involvement of NSAs in these processes. The Cotonou Agreement and EPA negotiations touch upon topics with which the various parts of NSAs are concerned to different extents. Not every civil society organisation is working on aspects relevant for development cooperation in general or trade issues in particular. Few NGOs have the expertise to engage in these topics. Consequently, it makes sense to focus on those parts of NSAs which are in the position to contribute to the process and which speak for groups likely to be directly affected by the results of the process. In the case of EPAs, it is expected that these groups would, as a minimum comprise, include private sector organisations, trade unions and civil society organisations engaged in economic and trade matters such as small enterprise promotion and the like.

In the following we discuss our main findings for Tanzania and analyse the reasons for the low level of current NSA engagement, distinguishing between internal constraints arising within the NSA community and external constraints.

#### 5.3.1 Internal Constraints for NSA Involvement

In Tanzania NSAs do not play the prominent role in EPA negotiations that is foreseen by the Cotonou Agreement. According to our findings, they are currently not aware of the extent to which they will be affected by EPAs. Thus far there has been almost no NSA involvement in the discussion of trade matters. Some reasons for the low level of NSA involvement lie within the NSAs' own organisational structures and have their roots in internal constraints. These internal constraints can be categorised and summed up as a lack of awareness, of capacity, of co-ordination, of funds, and, more generally speaking, a lack of experience with involvement in policy-making processes.

**Lack of awareness:** Almost all interviewees were not informed of the Cotonou Agreement, and of EPAs in particular. Most of the people informed

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35 Selection of the NSAs to be part of the working group should be at the discretion of the NSAs themselves. For this purpose, we support the idea of establishing a Trade and Poverty Advisory Council, as recommended in the Institutional and Organization Review (Tanzania Trade and Poverty Programme 2003).

about the Cotonou Agreement received their information from the media. None stated that they had been informed through any kind of promotion by the government or by the EU delegation in Tanzania. This goes hand in hand with a general lack of interest in trade topics among NSAs and especially among NGOs. Generally, there are very few NGOs engaged in trade matters. When asked about the issue, they state that they do not see the influence trade policy has on their work and vice versa. Surprisingly, many interviewees from private sector companies were not aware of Cotonou or EPAs either.

**Lack of capacity:** If NSAs want to identify their specific interest in EPAs, they require analytical skills to assess risks and opportunities. This is impeded by a lack of capacity in terms of missing expertise and know-how as well as in terms of lack of personnel to spare for trade topics. Most organisations, including private sector ones, have no staff knowledgeable in the sphere of international trade relations. This is also related to the fact that international trade relations and trade liberalisation are per se very complex issues. Their linkages to poverty eradication and other topics in which most NGOs are engaged is difficult to trace but nevertheless crucial for reaching the goals of development co-operation and the Cotonou Agreement in particular.

**Lack of co-ordination and organisation:** NSAs are a very heterogeneous group, which makes it difficult if not impossible for them to speak with one voice. The NSA community does not co-ordinate its efforts with a view to better consideration of their interests in the policy formulation process. This refers to the co-ordination between the various groups of NSAs and their umbrella organisations as well as to co-ordination within the different groups (see Box 5).

There are several umbrella organisations in Tanzania that seek to bundle the common interests of their members:

- the Tanzania Association of Non-Governmental Organisations (TANGO);

- the Trade Unions' Congress of Tanzania (TUCTA);
- the Private Sector Foundation, the apex private sector organisation;
- Viwanda na Biashara Ndogondogo (VIBINDO), representing the informal business sector.<sup>36</sup>

However, there is no formal forum which comprehensively backs the “non-state actor concept” proposed by the Cotonou Agreement. At present, lobby groups and their umbrella organisations seem to have difficulties in collecting, analysing, and disseminating relevant information to raise their members' awareness of the EPA process. Besides, the diversity of interests they have is often too broad to allow consensus to be reached. There also seem to be some constraints concerning the dissemination of information within the member organisations.

**Lack of experience with policy formulation processes:** We assumed that lack of experience with policy formulation processes would be another constraint for NSA involvement. This is only partly the case, as the Poverty Reduction Strategy (PRS) process has already introduced NSA participation in strategic policy issues to Tanzania. Even though this process is far from perfect and the stakeholders involved claim they have not been given the chance to respond to the papers presented to them, some parts of NSAs are familiar with the concept now. Some of them (like the private sector and TGNP and the civil society TEDET) have even taken an active part, pushed to be included in the process, and prepared statements and papers in advance. These activities are completely missing from the Cotonou and EPA processes at present.

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36 VIBINDO so far only represents the informal sector in the region of Dar es Salaam, but it is currently trying to establish a nation-wide body.

**Box 5: Different Levels of Co-ordination among NSAs**

To illustrate the situation, we will take a closer look at the levels of co-ordination within the different parts of NSAs. We will focus here on civil society organisations, the private sector, and within the private sector on agriculture.

**Civil society organisations:** So far there has been little or no involvement of civil society in the Cotonou process. Only a limited number of civil society organisations, like the Tanzania Gender Network Programme (TGNP) and the Tanzania Eco-Developm18

ent Trust (TEDET), are aware of EPAs and have staff knowledgeable on the Cotonou and EPA process. None of them have yet taken any active steps towards participation. Other civil society organisations are waiting for the government to invite them to participate, and finally there are NGOs not at all informed about the negotiations and their risks and opportunities. This to some extent contrasts with the experience of the PRS process, where some NGOs actively pushed for involvement, and it may be explained by the fact that trade is not usually perceived as an issue relevant to civil society.

**Private sector:** Within the private sector the situation is different. Large parts of the private sector, like the informal sector and the agricultural sector, have not yet undertaken any activities and mostly lack information and awareness. The Confederation of Tanzanian Industry (CTI) stands out as very well organised and prepared. This association efficiently keeps track of new developments, promotes its interests vis-à-vis the government and has a high pressure potential. CTI, however, mainly fosters protective trade policies, thereby delaying Tanzania's integration into the world and regional markets. As CTI represents only a minority of large manufacturing companies within the private sector, and an even smaller share of the NSA spectrum, there is the risk that this well-organised body may become too dominant compared to other NSAs that have not become part of the process yet. Still, with the private sector the one most directly affected by EPAs, all parts of it should be engaged in the preparation process. This is not the case at present, as also shown by the examples from the agricultural and manufacturing sectors.

**Agricultural sector:** One particularly relevant but difficult case is representation and co-ordination of the agricultural sector in trade policy formulation. On the one hand, the institutional framework for lobbying and promotion of policy interests is still very much the same as it was prior to Tanzania's structural adjustment and market liberalisation. There is a widespread perception that the government mostly confronts associations, commodity boards, and chambers with decisions already taken rather than involving them in the policy formulation process. On the other hand, most institutions are themselves still engaged in the transformation process towards a market economy. Stakeholders have not yet defined the role they may play for the benefit of their constituencies. Commercial farmers close to markets and small scale producers scattered in rural areas across the country obviously have very different needs and interests. The founding of the Tanzanian Chamber for Agriculture and Livestock (TCAL) indicates that farmers are aware of this bias of interests. While there is hope that the implementation of the Agricultural Sector Development Programme will provide incentives and support for increased participation of rural small scale farmers in policy formulation, under-representation of this sector's specific interests in national policy formulation processes will persist over the short and medium term.

**Manufacturing sector:** Tanzanian manufacturers were surprisingly uninformed about the Cotonou Agreement, upcoming EPA negotiations, and in particular the type of trade liberalisation envisaged in the EPA concept. Even members of CTI, arguably the most active business association in Tanzania, described themselves as at best "vaguely informed" about these issues at the time of the interviews. Consequently, the private sector is rather unprepared for the potential risks but also for the opportunities arising from an EPA as analysed above. One striking feature is that many businesspeople simply cannot imagine being left without protection from global competition. Various managers stated that their businesses would be seriously threatened by European imports if tariffs were eliminated, but were confident that the government would take the necessary steps to protect them from "unfair" competition.

### 5.3.2 External Constraints to NSA Involvement

The above finding is in line with the fact that the government has not established any systematic mechanism to facilitate NSA involvement in the Cotonou and EPA preparations. Regular meetings, round tables or any other form of exchange of ideas would not only facilitate participation but also serve as a legitimisation of involvement. Additionally, it would of course motivate and support NSAs to organise in a way that allows them to participate.

**Lack of government support:** Participation also depends on the government and its commitment to get NSAs involved. This commitment is largely absent so far. The government has until now not engaged in any activity aimed at raising awareness among NSAs, to support or encourage them to participate in the preparation process of EPAs. This may be due to the government itself struggling to find an organisational structure for EPAs, and it may change once such a national negotiation structure has been established. The PRS experience shows that this is possible.

**Lack of EU support:** What is provided for in the Cotonou Agreement led us to expect that the EU delegation would be actively involved in guiding the process of EPA preparations in Tanzania, including fostering NSA participation. However, the delegation's activities have been restricted to occasional publications on the general concept in the media. These include newspaper articles and the EU newsletter, which is, however, published only in English. Information is rarely published in Swahili, though such information would reach a much broader audience. The perception was confirmed that the discussions on EPAs have so far been Brussels-centred both on the side of both the EU and the ACP.

One noteworthy fact in this context is the engagement of one of the German political foundations, the Friedrich Ebert Foundation, which at the time of writing was the only organisation actively involved in building awareness and capacity in the area of Cotonou, EPAs and NSA participation in the related discussions and decision making processes.

### 5.3.3 Fostering the Involvement of NSAs: Some Recommendations

The analysis of the stage of NSA involvement showed shortcomings in the spheres of awareness, capacity, co-ordination and experience with policy formulation processes. The following recommendations suggest how to overcome these weaknesses and refer not only to the NSAs themselves but also to the other players involved, namely the government and the EU delegation.

**Raising awareness:** Increased dissemination of information about EPAs through the media will support awareness raising. Information should focus on the need for participation and point to explicit fields of interest to NSAs. The government needs to show its interest in NSA participation, raise the acceptance of their involvement and thereby legitimise it. It should show its willingness to support participation and use it as a tool to generate information about society's interests. The EU delegation should increase dissemination of information both in English and in Swahili. Additionally, it should promote the existing capacity building facilities and, if possible, engage in capacity building itself;

**Building trade capacity:** Training on trade issues (for example, on possible impacts of trade liberalisation in general and EPAs in particular) should address participants from the NSAs and the government in order to bridge the existing gap between these actors. The government and especially the EU delegation should better promote the funds available to NSAs for capacity building (for example, the 20 million euro capacity fund or the share of EDF money dedicated to NSA capacity building). The government should broaden NSA involvement by integrating them at an early stage and giving them the chance to respond to papers and proposals. NSAs should prepare to become involved in advance and insist on becoming part of the process. Those who feel responsible for the topic should submit papers on the relevant issues in advance to show their interest and competence on the issue. To push the process of involvement of NSAs on the side of the government, the EU delegation should repeatedly insist on NSA participation and demand



results from this process, as the World Bank did during the PRS process.

**Strengthening co-ordination and organisation:**

The government should establish a mechanism to facilitate the involvement of NSAs. This mechanism could have the form of the advisory council suggested by the TTPP (Draft Institutional Review 2002). The council would consist of stakeholders from the NSAs who would be consulted on topics concerning NSAs (the imbalance of participation within the private sector needs to be overcome by strengthening TCCIA, VIBINDO, TCAL and other umbrella organisations on the basis of capacity building measures and by giving them equal rights in the process of involvement (for example equal access to relevant meetings). Civil society organisations affected by the topic of trade liberalisation should no longer merely react to government activities and become actively involved and push for participation.

#### 5.4 Trade Capacity Building and further Recommendations

All of the above-mentioned ministries that deal with trade issues, in particular MIT, the ministry responsible for trade, lack capacity for trade policy analysis, negotiation and implementation, as has recently been noted by the Institutional Review of the TTPP. This seems to be associated with the rather low priority that the government has traditionally given to trade policy. Yet training of analytical skills is essential as a prerequisite for developing negotiation positions. It is therefore important not only to establish structures and mechanisms for the preparations of EPA negotiations but also to strengthen the trade capacity of the various stakeholders involved in trade policy formulation (see Box 6).

The ACP Secretariat and the European Commission established a Project Management Unit (PMU) to administer a 20 million programme for capacity building in the ACP countries and the regional economic groupings. It became operational in July 2002. Unfortunately, the PMU faced severe implementation problems. Currently, however, the main problem is a lack of project proposals from the ACP side. This indicates that capacity building has to start at an even earlier stage, i.e. to put countries in a position to make use of capacity building offers.

**Box 6: What Does Trade Capacity Building Mean?**

Despite the growing recognition of the importance and necessity of trade capacity building, there is no clear understanding among donors or the beneficiaries of technical assistance about its scope or its precise objectives. The aims of donor support can be split into two broad categories: support at the political level on the one side, and enhancing competitiveness of exporters on the other. The following definition confines itself to the political level, however, and includes both state and non-state actors as beneficiaries.

At the policy-making level, capacity building measures can in principle be carried out in the following areas:

**Analysis:** Analytical capacity to monitor trade issues is needed, as analytical work constitutes the foundation for the formulation of policies and the adoption of negotiating positions. Apart from the government, target groups should also be private sector organisations, trade unions, etc. Moreover, it would be important to build independent capacity for analysis and research on international trade.

**Formulation** of trade policies, i.e. subsequent to the identification of trade interests, formulation of objectives and strategies for their attainment. This includes managing information and networking with stakeholders.

**Negotiation skills:** Training is required to acquire negotiation skills revolving around strategic ability, skilful diplomacy based on greater interpersonal skills and improved teamwork.

**Implementation:** Capacity building to ensure that policies are actually implemented through training of standards agencies, trade facilitation bodies, etc.

Source: Solignac Lecomte (2001:13)

In Tanzania, there are currently two programmes in place working on trade capacity building: The Joint Integrated Technical Assistance Programme (JITAP) which is conducted by ITC, UNCTAD and WTO, and the Tanzania Trade and Poverty Programme (TTPP), which is designed and funded by DFID.

JITAP aims at assisting African countries to participate more effectively in the multilateral trading system. The programme has been in operation in eight countries since 1998. JITAP particularly focuses on capacity building with regard to the WTO system. Its main objectives are to build capacity for understanding the multilateral trading system and its implications for Tanzania; to help gear Tanzania's policy to seek maximum advantages from the multilateral trading system; and to enhance Tanzania's export readiness in selected key areas (Pallangyo 2003). Although the programme has faced financial constraints and management problems in the past, it has contributed to raising awareness and deepening understanding of the WTO Agreements.

TTPP is broader in scope and designed to develop capacity both inside and outside the government. Its aim is to build capacity among stakeholders to enable them to formulate and negotiate trade policies and strategies that are pro-poor, taking into account that Tanzania is involved in WTO, EU, EAC and SADC negotiations. Recognising that trade reform can boost the country's economic growth prospects and contribute to poverty eradication, the intention is to build capacity to ensure that trade reform serves poverty reduction and environmental sustainability objectives. According to the Project Memorandum, TTPP will also enable NSAs to understand and analyse the impact of trade reform, and to enter into a meaningful dialogue with government officials in order to influence trade policies and to monitor these policies.

TTPP is a relatively young programme that started in 2002. It consists of eight core components<sup>37</sup>, the

first of which was completed through submission of an Institutional Review. DFID will provide a total of £ 927,685 on grant terms over a three year period.

Given the scope and objectives of JITAP and TTPP, capacity building with regard to EPAs does not require setting up another special programme structure. Instead, EPA capacity building measures could become part of these programmes and make extensive use of local and regional expertise based at the university or in research institutes. Whereas TTPP focuses on institutional capacity development, EPA capacity building could be complementary and concentrate on individual capacity development and training of trade negotiators. Short-term expertise and trainings could be used to complement this, utilizing more specific and tailored training measures whenever needs are identified during day-to-day work concerned with the preparations for negotiations.

With respect to EPA capacity building, we therefore suggest that:

- Training should be made available urgently for the members of the proposed task force or the working groups on a short-term basis, as suggested above.
- As a means of internal capacity building, at least two consultants from within Tanzania should be recruited for the impact study on EPAs. The same goes for further studies and trainings to be carried out with regard to specific aspects of EPAs.
- With a view to the potential length of the negotiation process, and in order to strengthen capacity to interrelate with the Tanzanian delegation in Brussels, joint trainings should be arranged for participants from the capital and from Brussels.

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37 Components: 1. consultancy to identify linkages between trade policy and poverty reduction; 2. institutional and organisational review; 3. raising awareness of trade policy issues and improving dialogue between public and private

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sectors and civil society; 4. integration of trade issues in the national budgetary and economic reform process; 5. a fund for trade policy studies; 6. formal and informal capacity building in WTO and other trade issues; 7. provision of IT equipment; 8. a fund for essential participation in trade negotiating fora.

- Over the short to medium term, more systematic training should be envisaged for a broader group of stakeholders; this should be based at or coordinated with the available facilities at the University of Dar es Salaam and local research institutes.

## 6 The Regional Dimension of EPAs

### 6.1 The Role of Existing Regional Integration Initiatives in the EPA Negotiations

EPAs are seen as a means to consolidate and deepen processes of regional integration within the ACP by fostering trade reforms, promoting common rules and enhancing openness and transparency of markets.<sup>38</sup> The EU prefers therefore to negotiate EPAs with regional groupings rather than with individual countries. It is, however, up to the ACP countries themselves to decide whether they want to negotiate a regional or an individual EPA.<sup>39</sup>

If the members of an existing regional initiative (RI) decide to negotiate an EPA as a group, they have to agree on common positions to speak with one voice in the forthcoming second phase of the negotiations. Consequently, it is important for regional initiatives to identify rules and mechanisms concerning how best to work out and adopt common positions on relevant issues. Within this process the regional secretariats can play an important role as facilitators and co-ordinators of the preparations for EPA negotiations.

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38 The European Commission first argued that EPAs should replace the existing arrangements under the Lomé Convention to establish a WTO-compatible trade agreement. Only later did the European Commission promote EPAs as a means for regional integration.

39 The Cotonou Agreement, article 37.5, states: “*Negotiations of the economic partnership agreements will be undertaken with ACP countries which consider themselves in a position to do so, at the level they consider appropriate and in accordance with the procedures agreed by the ACP Group, taking into account regional integration process within the ACP.*”

In the present study we have assessed the state of regional integration and examined the preparedness for EPA negotiations in the East African Community (EAC), which is one regional option for Tanzania. The heads of state of the three members of EAC (Kenya, Uganda and Tanzania) in addition declared, in April 2002, that they intend to negotiate trade issues “as a bloc.” First, we outline which ACP regions are eligible for EPA negotiations from the EU’s point of view and briefly delineate the opportunities and risks of an EPA for RIs. Second, we analyse the current state of EPA preparations at the regional level. The chapter concludes with recommendations on what has to be done to facilitate and accelerate the EPA preparation process at the regional level.

#### 6.1.1 Required Qualifications for ACP Regions

Even though it is the ACP’s prerogative to decide on the actual geographical configuration of future EPAs, the European Commission has formulated guidelines to provide orientation on the eligibility of regional groupings for EPA negotiations (European Commission 2001). According to these guidelines, regional groupings that have implemented a customs union or have legally binding agreements to do so, are seen as offering the best conditions for the attainment of the provisions of the Cotonou Agreement. Additionally, the Commission has stated its view that ACP countries that are members of an eligible regional integration initiative should not be eligible for EPA negotiations on an individual basis (European Commission 2001:12).

The paper also addresses the case of overlapping memberships between two or more regional groupings. According to the European Commission, negotiations of two or more EPAs with the same country are not conceivable. Countries that are members of different regional groupings are therefore asked to decide within which grouping they intend to negotiate an EPA. This does, however, not imply that they are required to step out of the RI with which they do not negotiate an EPA. Furthermore, it is also a regional EPA cannot include broader regional con-

figurations which go beyond the current regional economic integration frameworks.

In summary, the Commission's position on regional EPAs comprises five basic components (Bilal 2002:21):

- EPA negotiations should take place within a regional framework;
- each ACP country can only negotiate once, regardless of multiple memberships;
- each EPA should be self-contained and hence does not allow for overlapping or competing initiatives;
- all members of a regional grouping negotiating an EPA must speak with one voice;
- within the process of negotiating an EPA, a multi-speed approach may be envisaged.

### 6.1.2 Opportunities and Risks for Regional Initiatives in the EPA Process

Whether EPA negotiations at the regional level act in favour or against deepened integration in the ACP regions depends on the region's preparedness for common trade negotiations. The process of negotiating a regional EPA entails both opportunities and risks for internal integration processes.

**Opportunity for deeper integration:** EPA negotiations can have a positive effect by assisting the regional organisations to harmonise their trade regimes, thus strengthening the regional integration process (Trades Centre 2002b:60). As the establishment of an FTA or a customs union is a precondition for negotiating an EPA, EPA preparations can act as an incentive for regional initiatives to set up such trade agreements in a shorter period of time than initially foreseen.

**Opportunity for wider integration:** EPA negotiations at the regional level call for a solution for overlapping memberships between different re-

gional initiatives, a situation that is widespread in Southern and Eastern Africa. One solution could be for different regional groupings to form alliances, harmonise their negotiation position and agree on the same trade arrangements with the EU. If this is the case, EPAs can act as an incentive to deal with overlapping memberships as well as a driving force for wider regional integration. Irrespective of the technical issues to be addressed to make such an arrangement feasible, it may be expected that one broad regional integration initiative as a replacement for the existing proliferation of regional initiatives will enhance bargaining power vis-à-vis the EU and have positive effects on the economic performance of the member states.<sup>40</sup>

**Risk of overstretching the regional initiatives:** EPA negotiations could also have negative effects on regional integration processes in Africa, for example by imposing over-ambitious timetables on the RIs (cf. Qualmann/ Rojahn 2002). Many RIs are currently working on major integration projects themselves.<sup>41</sup> These projects absorb most of the manpower and negotiating capacity available in the often understaffed regional secretariats. The pressure to start trade negotiations with the EU in a phase of internal restructuring and change bears the risk of overstretching capacity and demanding too much of the RIs, whose institutional structure is not yet consolidated. Furthermore, EPAs focus mainly on trade and economic issues, while existing RIs also have political and development objectives which may not be taken sufficiently into account during the EPA negotiations.

**Risk of conflicts among member states and among regional initiatives:** To negotiate a regional

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40 Sharer (2001:16f.) states: "*The complexity of Africa's trade arrangements reduces the potential trading gains from regionalism and undermines improvement in the investment climate that arises from larger markets, added certainty and stability of policies, and improved transparency (...). Finally, it may weaken reform momentum by dissipating the political capital needed to pursue reforms and fostering the very favouritism and special interests that trade liberalisation is supposed to overcome.*"

41 COMESA and EAC plan to establish a customs union by 2004, and the SADC members have agreed on implementing an FTA by 2008.

EPA, the member states of the RI in question have to agree on common positions towards the EU. This can be a difficult, possibly conflictive task, as the RIs often consist of heterogeneous countries with rather different trade interests. One major distinction lies between LDCs and DCs, because LDCs currently benefit from preferential market access to the EU market under the EBA initiative and therefore have relatively more to lose in an EPA than their DCs partners (see Chapter 3). More industrialised countries have a higher interest in protecting their manufacturing sectors than LDCs, which prefer to protect the agricultural sector instead. This raises the question as to which sectors are to be included and how fast liberalisation as a group will be economically and politically feasible. To decide on these issues for the EPA negotiations is a challenging new task for RIs, as most of their member states still have divergent trade and economic policies in place.

Conflicts may also emerge between different RIs. To prepare EPAs, RIs are forced to co-operate more closely in order to agree on the geographical configuration of future EPAs. This can lead to the harmonisation of the different integration processes in the region as well as to wider regional integration, as described above. However, the need to co-operate can also cause conflict. This could e.g. be the case if different RIs in Eastern and Southern Africa are required to establish an FTA as a precondition for an all Eastern and Southern Africa-EPA in order to solve the problem of overlapping membership. The existing RIs have various interests, objectives and internal timeframes and it is doubtful whether these can be harmonised to the satisfaction of all the countries in question.

EPAs can serve as a means to foster regional integration. Whether the RIs can seize this opportunity depends, however, on how successfully they can defend their interests and needs in the negotiations with the European Commission. It is therefore necessary for them to define strategies on how the opportunities of an EPA can be best used and risks be avoided. In the following section we examine how the EAC is dealing with this challenge of preparing EPA negotiations.

## **6.2 The Case of the East African Community (EAC)**

The EAC is a positive example for regional integration efforts in Africa. Established only in 2000, its three member states, Kenya, Tanzania and Uganda, are following a straight path towards economic and political integration. From this perspective EAC is a likely geographical option of an EPA for Tanzania, and we have therefore integrated the EAC's state of preparation in our study. The following section first gives an overview on the EAC's integration efforts, and, second, outlines the current state of EPA preparation by analysing the opportunities and risks of an EPA for the special case of the EAC. Finally, we recommend a way forward for EPA preparations at the regional level.

### **6.2.1 Internal Structure and Integration Efforts**

The current EAC is a re-launch of the first East African Community, which lasted from 1967 to 1977. These considerable integration efforts were discontinued mainly because of the partners' divergent political regimes and development strategies. When the general political and economic conditions changed in favour of closer co-operation in the 1990s, Kenya, Tanzania and Uganda agreed to re-launch regional integration in East Africa. This process led to the signing of the "Treaty for the Establishment of the East African Community" in 1999 and its ratification in 2000. The Treaty provides for a unification process following four steps: a customs union, a common market, a monetary union and, finally, a political federation.

The main strengths of the EAC are: the common cultural ground, especially the languages Swahili and English, the political stability in the region and the basically compatible legal and political systems, which go back to the countries' shared past under British colonial rule. Another factor working in favour of the Community is the presence of co-operation pressure, due e.g. to the common use of Lake Victoria or cross-border wildlife migratory routes. Beneath these common interests and shared goals, tensions and divergences of opinion exist

among the partners. There is political disagreement as well as there are economic constraints, such as Tanzania's fear of the Kenyan economic dominance in the EAC (cf. Mair 2001:165).

The EAC does not yet have a strong regional institutional structure. Decisions are taken unanimously by national representatives of the three member states. The existing regional bodies, like the EAC Secretariat and the East African Legislative Assembly (EALA), are understaffed in view of the tasks that lie ahead of them and only deal with administrative and technical tasks, because they lack the mandate to take binding decisions.

At the time of writing, member states and the EAC Secretariat were working on the completion of the EAC Customs Union Protocol, which was planned to be approved by Ministers in November 2003. The establishment of the customs union is an important step for EAC to enter into an FTA with the EU and therefore beneficial for EPA negotiations. Furthermore, it is likely that the customs union will go along with a qualitative and quantitative enhancement of the EAC Secretariat.<sup>42</sup>

### 6.2.2 State of EPA Preparations

The EAC member states have undertaken first steps to prepare for common trade negotiations. The process is, however, still in its beginning and it is not clear whether the above-mentioned opportunities or risks of an EPA will prevail in the case of the EAC. The following section outlines the state of EPA preparations in the EAC and its shortcomings.

**Opportunity for deeper integration:** In view of the forthcoming EPA negotiations and the new WTO round, the heads of state of the EAC member countries declared in April 2002 that the three coun-

tries should negotiate as a bloc in future trade negotiations. This is an important step towards deeper integration, since previously there was no cooperation on trade issues. To put the heads of states' decision into practice, the member states, in collaboration with the EAC Secretariat, organised a workshop in October 2002 ("East African Community Negotiating as a Bloc") with participants composed of the EAC ambassadors in Brussels and Geneva, trade experts, staff from the EAC Secretariat and representatives of all ministries involved. The participants recommended that the EAC member states should agree on common positions which should become "official EAC positions" for EPA negotiations. The EAC Secretariat was to play a more important role as a co-ordinator and facilitator for the preparation of negotiations. Through these initiatives, the EAC has already taken the EPA preparations as an opportunity to plan closer regional cooperation on trade issues (cf. EAC Secretariat 2002).

**Opportunity for wider integration:** The EPA preparation process has already led to some activities among the RI to tackle the questions arising from EPA negotiations. First consultations have taken place between EAC, SADC and COMESA, with COMESA playing the most active role in the process. For COMESA the most favourable option is one single EPA covering the whole Eastern and Southern African region (COMESA 2002a: 14). An impact study commissioned by SADC on "Impact Assessment of Economic Partnerships Agreements on the SADC and Preliminary Adjustment Scenarios" draws the same conclusion and recommends "that SADC form [...] alliances among regional partners for the negotiations of the EPAs" (Trades Centre 2002a:XV).

A general framework to ensure coherence among regional initiatives in Eastern and Southern Africa has been formulated in the common Regional Strategy Paper of IOC, COMESA, EAC and IGAD, which includes a Regional Indicative Programme (RIP) to be financed under the 9<sup>th</sup> European Development Fund. The RIP foresees the establishment of an Inter-Regional Co-ordination Committee (IRCC) between the four regional initiatives and representatives from SADC. The IRCC does not have the

42 The "Study to Develop a Legal, Institutional and Administrative Structure for the Customs Union", commissioned by the EAC Secretariat, provides detailed information on this topic. The consultants propose, for example, to set up a Customs, Fiscal and Trade Group in the Secretariat, consisting of seventeen divisions with a total staff of 129 (cf. imani development 2003:7).

mandate to deal with the EPA preparations, but it should nevertheless serve as a forum for dialogue on crucial issues, like overlapping memberships between the regional initiatives and technical problems resulting from different sets of common external tariffs or rules of origin.

**Risk of overstretching the regional initiatives:** All key stakeholders dealing with EAC matters at the national and regional level are working on completion of the Customs Union Protocol. The establishment of the customs union is favourable with regard to EPAs; it is, however, also a considerable challenge for the EAC. The customs union not only demands intensive negotiations on the content of the Protocol, it also has to be accompanied by creation of the respective legal, institutional and administrative framework. According to a study on these issues commissioned by the EAC Secretariat, substantial structural reforms at the national as well as at the regional level are needed (cf. Imani development 2003). The challenge involved in completing the customs union as foreseen may be the main reason why EPA negotiations are not at the top of the agenda of most of the relevant stakeholders. There is obviously some interference between the internal EAC timeframe and the projected start of EPA negotiations in September 2003.

The EPA concept provides for negotiations between the European Commission and regional initiatives. The concept does not take into account the state of integration of most of the RIs in Africa. In the EAC, the internal integration process is not advanced and the common policies not convergent enough to enter into common trade negotiations. On the EU side, the Commissioner of Trade represents all EU member states in the EPA negotiations. On the EAC side, in comparison, there is neither a supranational body with the mandate to negotiate for the member states nor are there mechanisms in place to reach agreement on common EAC positions for negotiations with third countries. It is, for example, not clear how responsibilities for trade issues are shared between the EAC Secretariat and the national officials dealing with EAC matters. One main problem in this context is the limited capacity of the EAC Secretariat: Only two staff members are responsible for all macroeconomic issues, including fiscal and

monetary aspects, and EPAs are only one of the many topics relating to trade issues that have to be dealt with.

In face of the difficulties that parallel negotiations on the customs union and EPAs cause for the EAC and its member states, the question is whether the EAC member states should consequently plead for a postponement of the start of EPA negotiations at the regional level until they have finalised the Customs Union Protocol, or whether they should decide to start negotiations in parallel, as provided for, in September. In either case, substantial efforts need to be made to strengthen negotiation capacity on trade issues at the regional level.

**Risk of conflicts among member states and among regional initiatives:** The analysis of the preparation process at the EAC level has revealed that even though some first steps have been taken towards common trade negotiations, there is still a lack of the concrete action needed to put the necessary mechanisms in place. It seems as though the decision of the heads of state to negotiate as a bloc is only a political statement, one at present without any binding character. This situation is reflected in the fact that opinions about the potential geographical configuration of an EPA for Tanzania still differ among the stakeholders. According to some, Tanzania will certainly negotiate within an EAC framework. For others, this decision still depends on the conclusion of an EPA impact study for Tanzania and is rooted in both political and economic rationales. The uncertainty over whether or not the EAC will start EPA negotiations may also be the reason why the above-mentioned recommendations on the potential structure and mechanisms of the preparations for EPA negotiations have not yet been put into place.

The situation is especially difficult in case of the three EAC member states, as they all have two regional options for EPA negotiations: Kenya and Uganda could also negotiate with COMESA, Tanzania could negotiate with SADC (see Box 7). For none of the countries it is clear what the potential gains and losses of each arrangement may be. Tanzania may be reluctant to decide in favour of the SADC option as long as it is not clear how it will be

**Box 7: The Geographical Configuration of an EPA: Options for EAC Member States**

**Option 1:** All three countries withdraw from any regional initiative except EAC and negotiate an EAC-EPA. As the countries have economic and political interests in remaining member of different RIs, is it doubtful whether this option is feasible.

**Option 2:** Tanzania resigns from SADC, Kenya and Uganda resign from COMESA, but they retain a special, “associated” membership, which allows them to negotiate an EAC-EPA without losing touch with other integration processes in the region. The associated membership status should grant the right to attend meetings, but not to vote, and should be free of tariff obligations and involve lower membership fees (Imani development 2003:24). It has to be examined whether an associated membership would still enable the countries to defend their interests in each RI.

**Option 3:** Tanzania resigns from SADC, rejoins COMESA, and EAC forms a “fast track group” within COMESA. The twenty members of COMESA could negotiate a common EPA with a more ambitious timeframe for EAC members, as the latter have already established a customs union and COMESA members have not. It is questionable whether this option is in any aspect attractive for Tanzania. For political and economic reasons, Tanzania wants to remain a member of SADC and to keep up a strong relationship with South Africa.

**Option 4:** COMESA, EAC and SADC agree on a common EPA and therefore harmonise their trade policies with the aim of establishing one broad FTA in the region. Further research is needed to analyse whether it is realistic that the twenty five, rather heterogeneous, members of the three RIs could agree on rules and mechanisms to establish one single FTA in Southern and Eastern Africa.

possible to give due consideration to the country's status as an LDC during the negotiations at the regional level; i.e. how special and differential treatment can be guaranteed for LDCs negotiating in a regional grouping with non-LDCs. Another problem for Tanzania is its vital interest in remaining a member of two regional initiatives: SADC and EAC.

The issue of the problematic geographical configuration of EPAs could be mitigated through closer co-operation among the different RIs. Unfortunately, even if the stakeholders are aware of the difficulties arising from overlapping memberships, there is at present neither an institutionalised consultation structure among the regional initiatives nor are there any systematic attempts to discuss these very critical but politically sensitive issues. The planned regional forum, IRCC, has not yet been established. The question is whether this lack of action with regard to EPA negotiations is only due to capacity constraints at the national and regional level or whether it is as well a sign of a lack of political will to deal with EPAs. EPAs are seen among some stakeholders in Tanzania as a concept that comes from outside and that is not appropriate for the specific situation in Eastern and Southern Africa.

### 6.2.3 The Way Forward: Challenges and Recommendations

The analysis of the preparation process in the EAC has revealed that the Community and its member states are not in the position to formulate key interests and common positions. They are for this reason unable to enter into EPA negotiations with a strategy which would enable them to seize the opportunities of an EPA and to avoid potential risks. We have identified three obstacles which are hindering more effective preparations at the regional level:

- lack of binding decisions with regard to EPA negotiations;
- lack of a clear assignment of responsibilities among the decision-makers;
- lack of pro-active engagement to deal with EPAs both at the EAC and the national levels.

One reason for the lack of initiative among the key stakeholders is that they are neither sufficiently aware of the potential economic benefits and losses of an EPA nor do they know what kind of institutional reforms are needed to conduct negotiations with the EU at a regional level. The necessary political decisions with respect to EPA negotiations



can only be taken if both the economic effects of an EPA for the region and the necessary institutional reforms have been assessed. Only on the basis of clear decision criteria it is possible to define the region's key interests and outline a common negotiation strategy.

**Assessment of the potential economic benefits and losses for the EAC region:** If they are to identify reasonable and promising negotiation issues, it is crucial that the member states be aware of the effects that an FTA with the EU might have on their economies. Thus it is essential that an impact study on the economic and social effects of an EPA on the EAC region be conducted as means of preparing and defining negotiation positions. Once they are in possession of the results of such an impact study, it will also be easier for the three member states to agree on common positions. The study could be based on the terms of reference for a "Study on Impact Assessment of Economic Partnership Agreements and Preliminary Adjustment Scenarios" at a regional level formulated by the ACP Secretariat. Funding can be provided by the EU through the capacity building fund for EPA negotiations.<sup>43</sup> Such a study should be based on the findings of former impact studies like and the present report. However, it is necessary for the study to go beyond the scope of these studies by paying more attention to the fiscal implications of an EPA, including the dynamic effects, and by assessing in a more detailed manner the economic impact on different sectors, including the social implications.

**Proposals on institutional and administrative reforms:** The decision makers lack information not only on the economic impact of an EPA but also on the institutional and administrative reforms that an EPA would entail for the regional initiatives and their member states. It is certain that a qualitative

and quantitative step towards deeper regional integration has to be taken to enable the EAC Secretariat to conduct EPA negotiations at the regional level. We suggest that a study be commissioned to examine how common trade negotiations at an EAC level could be administered, and in particular on how the EAC Secretariat's mandate could be transformed or extended in order to enhance its status.

Within this context of institutional change, one main challenge is to find a solution for overlapping memberships. As stated above, a single country cannot negotiate an EPA with two different RIs. This problem is not only a result of EPA negotiations, it also emerges as soon as two RIs implement a customs union: Members of one customs union are not allowed to be members of another customs union, since they are required to implement the CET and cannot grant preferential rates of duty to other states on their own.<sup>44</sup>

Lack of information on what is in an EPA for RIs is only one reason for the rather modest state of preparations so far. The other reasons may include, as stated above, capacity constraints as well as a lack of political will. Even if the decision makers are not convinced of the merits of an EPA concept, and are thus not eager to push for this issue, the second phase of negotiations will nevertheless start in September of this year. The RIs and their member states have to prepare themselves to defend their interests towards the EU as successfully as possible and to be able to seize the opportunities presented by an EPA. We therefore suggest the following next steps to invigorate the preparation process.

**Recommendations:** If the member states are willing to conduct EPA negotiations as a bloc on the basis of common positions, and with the EAC Secretariat playing a co-ordinating role, there is a chance that EPA negotiations may make a contribution towards deeper integration among the EAC countries. Given the EAC Secretariat's mandate to facilitate and co-ordinate the EPA preparation process, we recommend that the Secretariat be given a

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43 SADC has already completed the above-mentioned impact study. The study, "Impact Assessment of Economic Partnerships Agreements on the SADC and Preliminary Adjustment Scenarios," recommends that all SADC countries should negotiate a common EPA with the EU. As to geographical configuration, the study recommends that SADC countries could negotiate jointly with COMESA and EAC (cf. Trades Centre 2002a).

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44 This problem will not occur if the two customs unions agree on an identical CET.

more active role in the process. As a means of enabling the EAC Secretariat to assume this role, we suggest:

- that the responsible Ministries in the member states take a binding decision to negotiate an EPA within the EAC;
- handing over responsibilities to the regional level by giving the EAC Secretariat the official mandate to co-ordinate the preparation process;
- agreeing on a division of labour between the EAC Secretariat and the national level;
- establishing a regional negotiation team consisting of representatives from the member states and the EAC Secretariat;
- strengthening capacity in the EAC Secretariat by hiring there, as a minimum, one additional trade economist.

Preparation for trade negotiations is a complex process involving the identification of vital interests, the promotion of dialogue between all key stakeholders and the creation of mechanisms to prepare a common negotiation strategy. To support the responsible stakeholders in dealing with these tasks, we suggest:

- commissioning an impact study on the effects of an EPA on the EAC economies as a group, including not only the economic impact but also the necessary institutional reforms;
- identifying crucial issues for the negotiations and establishing working groups to deal with these issues;
- intensifying the dialogue with other RIs to co-ordinate the preparation process and to find solutions for technical questions bound up with the EPA negotiations.

## 7 Conclusions and Recommendations

The aim of the present study was to shed light on the preparations and potential impact of EPAs in ACP countries. We have taken Tanzania as a case study to identify, on the one hand, the potential opportunities and risks of an EPA and to analyse, on the other hand, the mechanisms of strategic policy formulation for the negotiations. Whereas many of the details on the institutional set-up and economic implications are country-specific, we do believe that some of our findings are not only valid for the case of Tanzania but can also be applied to the situation in other ACP countries, especially LDCs. The country-specific conclusions and recommendations are reported in the chapters above. In this final chapter we focus on findings that can be generalised for other ACP countries. The chapter concludes with recommendations generally applicable for ACP countries, including a number of areas where the European Commission and the broader donor community should become active and support partner countries in preparing for EPA negotiations. This final step is based on our analysis on the extent to which EPAs can potentially contribute to development and poverty reduction in ACP countries, and how negotiations can be used to shape the EPA concept in this respect.

The objectives of EPAs were inferred from Article 1 of the Cotonou Agreement, which stipulates that cooperation between the EU and the ACP states will “be centred on the objective of reducing and eventually eradicating poverty consistent with the objectives of sustainable development and the gradual integration of the ACP countries into the world economy.” The main means to achieve these objectives is establishment of reciprocal free trade between the EU and ACP countries, or preferably ACP regions. The underlying rationale is that trade liberalisation will lead to trade creation, and as such increase welfare. But trade liberalisation does not translate automatically into benefits – especially not in least developed countries, let alone for the poor in these countries – if this is not actively supported by and embedded in a whole range of other policy measures. How trade liberalisation can be made pro-poor is not outlined in the “EPA concept”. This demands a thorough analysis of the impact of spe-

cific policies on vulnerable groups, and an appropriate sequencing and timing of trade liberalisation.

The state of preparedness for EPA negotiations was found to be alarmingly low at both the national and regional level. The process of deep regional integration is only now beginning in most of the ACP regions, a fact which implies that regional authorities, such as the secretariats, do not have the capacity or the mandate to actually formulate and negotiate external trade policy for a designated region. The question is whether the countries are willing to transfer responsibility to the regional level and whether the regional secretariats will be put in a position to play a leading role in the preparations for joint trade negotiations. The issue of overlapping memberships will make these decisions even more difficult in Eastern and Southern Africa. Decisions by individual countries on the regional framework under which they wish to negotiate have potentially far-reaching implications. The initial timeframe set by the Commission for EPA negotiations did not take into account the reality of regional integration and the negotiation capacity of most RIs in ACP countries.

The possibility to negotiate EPAs, however, is an opportunity in itself, since it gives the ACP countries the chance to influence the eventual shape of an agreement, and thereby to maximise the benefits and reduce the risks. This, however, presupposes that ACP countries are actually in a position to do so, i.e. to analyse, formulate and pro-actively negotiate their position. This in turn requires analytical and institutional capacity, which is scarce in most of the countries concerned. Considering their limited capacity, it is necessary for ACP countries to set clear priorities for trade policy formulation and negotiation, and to implement the measures needed for institutional re-structuring and capacity building.

Establishing reciprocal free trade between the ACP and the EU will result in revenue loss and at the same time increase import competition. Governments may have fewer resources to provide complementary measures, and may even cut back expenditure in the social sectors, as has been experienced in many countries during structural adjustment programmes. Although our study revealed that

in the case of Tanzania total revenue loss may not be as severe as often feared, the loss incurred is likely to make it necessary for ACP countries to find alternative sources of revenue to compensate for tariff revenue losses and to restructure their revenue collection schemes. These in turn also need to be pro-poor if the poor are not to be worse off than without EPAs.

One serious shortcoming of the EPA concept lies in the fact that it is silent on the question of how different levels of development of the member countries in the existing regional integration initiatives are to be treated in an EPA. This creates uncertainties mainly among LDCs, which fear to lose the preferential status they enjoy under the EBA initiative.

If EPAs are to open up opportunities - including for LDCs - and if adjustment costs are to be limited, we therefore recommend that ACP countries need to negotiate for:

- an outcome as close as possible to the EBA scheme in terms of a total abolition of all tariffs and quotas on all ACP exports;
- elimination of NTBs and extended supply side assistance to reduce export and production constraints;
- special and differential treatment for LDCs, especially if they negotiate a joint EPA with non-LDCs.

Reform of the EU's CAP would be essential for any further opening of the EU agricultural markets for ACP products; but it is acknowledged that other forums are better suited to put pressure behind this issue.

Based on our findings, we furthermore conclude that there is an urgent need for ACP countries to recognize the significance of trade issues for development and poverty reduction, and subsequently to put themselves in the position to outline a negotiation strategy which enables them to put their key interests on the agenda.

To achieve this task, we recommend:

- ensuring that relevant national policies, such as agricultural policy, include poverty reduction programmes, as this is a precondition for making efficient use of trade programmes and paving the way for pro-poor growth;
- commissioning impact studies to reduce uncertainty concerning the potential benefits and losses of an EPA;
- deciding on the geographical configuration of EPAs and, if possible, commissioning an impact study on how to solve technical problems arising from overlapping memberships;
- setting up a national task force to co-ordinate EPA negotiations with a view to overcoming the fragmentation of responsibilities in the field of trade policy formulation and establishing a focal point for all relevant stakeholders, such as the private sector and civil society.

Assistance from the donor community in building trade capacity will be necessary to enable the ACP countries to be equal partners. Although there appears to be a contradiction in the fact that for all ACP countries the EU and its member states are both development and trading partners, the European Commission and bilateral donors do offer a number of support activities with respect to trade capacity building. Naturally, as the negotiating partner, the EU cannot assist the ACP countries in determining their negotiating positions. But the EU, in particular the EU delegations in the field, can help to raise awareness by disseminating information, especially about available funds and programmes for capacity building. It is then up to the ACP governments and stakeholders to make effective use of them.

To make EPAs an effective instrument for the integration of the ACP states into the world economy in a way consistent with the overarching objectives of poverty reduction and sustainable development, we recommend that the EU

- provide flexibility regarding timeframes to give regional groupings enough time to further integrate;
- clarify whether and how the EPA concept takes into account special and differential treatment for LDCs;
- ensure that applications for funding and trade capacity building are processed in an efficient and timely way;
- make the EU delegations in the field responsible for the dissemination of information about EPAs as well as for awareness raising among the various stakeholders about potential implications of EPAs;

Foster and insist on the involvement of NSAs in trade policy formulation, since this was seen as one of the fundamental principles when the Cotonou Agreement was signed.

Further, we suggest that the donor community, especially the EU member states, should

- assist in trade capacity building, wherever trade capacity building is not yet on the agenda;
- co-ordinate trade capacity building efforts to avoid any fragmentation of various projects and programmes by different donors and to increase effectiveness;
- make EPA capacity building an element of already existing trade capacity building programmes;
- ensure that trade capacity building programmes take into due account national strategies and sectoral policies touching upon trade issues and poverty reduction and build on them.

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# **Annexes**





**Annex A: Lists of Interviews Conducted**

<b>Institution</b>	<b>Name</b>
ACP Secretariat, Brussels	Mr Ahmed Ndyeshobola
Association of World Council of Churches related Development Organisations in Europe, Brussels	Dr. Karin Ulmer
East African Community (GTZ Advisor) , Arusha	Dr. Heinz-Michael Stahl
Economic and Social Research Foundation, Dar es Salaam	Dr. Josephat Kweka
Embassy of Tanzania, Brussels	Dr. Prosper Mbena
European Commission, Brussels	Dr. Ingo Feustel
German Federal Ministry of Economic Co-operation and Development, Bonn	Mr Reinhard Palm Dr. Eefje Schmid
President's Office, Planning and Privatisation, Dar es Salaam	Ms Diana Makule
World Economy, Ecology and Development, Bonn	Mr Klaus Schilder

<b>Institution</b>	<b>Name</b>
Business Associations and Private Sector Promotion Agencies	
Board of External Trade	Mr Yusufu Kashangwa
Board of External Trade	Mr K.S. Mwashu
Confederation of Tanzanian Industries, Arusha Office	Mr Daniel E. Mghwira
Confederation of Tanzanian Industries, Dar es Salaam	Mr Hussein Kamote Mr Geoffrey Mackanja
East African Business Council	Mr Elly Manjale
Small Industries Development Organisation, Arusha	Mr Abdallah S. Kiluvia
Small Industries Development Organisation, Dar es Salaam	Mr Mike Laiser
Tanzania Bureau of Standards	Mr Charles M. Ekelege Mr Bethuel Matemba Ms Beatrice M. Mutabazi
Tanzania Chamber of Commerce, Industry and Agriculture, Dar es Salaam	Mr Matiko
Tanzania Chamber of Commerce, Industry and Agriculture, Arusha	Mr Edwin W. Shetto
Tanzania Coffee Board	Mr Frederick S. Mpangile
Tanzanian Board for Agriculture and Livestock	Mr E.R.K. Mshiu

<i>(A2 continued)</i>	
Tanzanian Board for Agriculture and Livestock	Mr Salem Shamte
Tanzanian Coffee Producers Association	Mr Mtei
Trade Union's Congress of Tanzania	Mr N.K. Ngulla
<b>Donor Community</b>	
Embassy of the Federal Republic of Germany	Dr. Enno Barker Mr Hady Riad Mr Peter Zinngraf
Centre for Development of Enterprise	Mr Francis P. Mwimanzi
Department for International Development	Mr Iain Jones
Embassy of Sweden (SIDA)	Mr Bertil Odén
European Commission	Mr Axel de Lamaisonneuve Ms Helen Tilly Mr Joachim Zeller
Friedrich Ebert Foundation (FES)	Mr Peter Häussler Ms Angela Ishengoma Ms Silvia Riad
German Technical Co-operation	Mr Detlef Mey
Royal Netherlands Embassy	Dr. Bernard Berendsen Mr Willem L. Bronkhorst Mr Steven Collet
World Bank	Mr Philip I. Mpango
<b>East African Community</b>	
East African Community Secretariat	Mr Nyamajeje C. Weggoro
East African Community Secretariat	Mr Peter Kiguta
East African Community Secretariat	Ms Mary N. Makoffu
East African Community Secretariat	Ms Isabele Waffubwa
East African Community Secretariat	Mr M.D.Sajjabi
East African Community Secretariat (GTZ Advisor)	Dr. Heinz-Michael Stahl
East African Legislative Assembly	Ms Kate Kamba Ms Sheila Kawamara-Mishambi Ms Irene Ovonji-Odida
<b>Government</b>	
Ministry of Agriculture and Food Security	Ms Margaret Ndaba

<b>(A2 continued)</b>	
Ministry of Agriculture and Food Security	Ms J. F. Bitegeko Mr Munisi
Ministry of Finance	Mr D. M. Msangi Mr Eliud T. Nyauhenga
Ministry of Finance	Mr Pius Mponzi
Ministry of Foreign Affairs and International Co-operation	Mr Moses T. Kibwana
Ministry of Foreign Affairs and International Co-operation	Mr Mboyi
Ministry of Foreign Affairs and International Co-operation (SADC Desk)	Mr Pastor Ngaiza
Ministry of Industry and Trade	Ms Bulondo
Ministry of Industry and Trade	Mr Bede Lyimo
Ministry of Industry and Trade (JITAP)	Mr A. T. Pallangyo
Ministry of Industry and Trade	Mr Mussa Uledi
Ministry of Finance and Economic Affairs (Zanzibar)	Mr Joseph Abdalla Meza
Ministry of Finance and Economic Affairs (Zanzibar)	Mr Rashid Kibao Mr Idriss Shamte
President's Office, Planning and Privatisation	Mr Mrango Ms Diana Makule
Tanzania Investment Centre	Mr Emmanuel Naiko
Tanzania Revenue Authority	Mr Tonedeus Muganyizi
Tanzania Revenue Authority	Mr S.S. Yusufu
Tanzania Revenue Authority	Mr Kangoye
Zanzibar Investment Promotion Agency	Ms Alice Kipogo
<b>NGOs</b>	
Centre for International Business Development Services	Mr Remmy Temba
Jobs for Africa	Mr Damas Dandi
PRIDE Tanzania	Mr James J. M.Obama
Tanzania Eco-Development Trust	Dr. Mushagwe
Tanzania Gender Network Programme	Ms Rebecca Muna
<b>Private Companies</b>	
A to Z Textile Mills Ltd.	Mr Binesh Haria
Arusha Aggregates Ltd.	Mr Kanti V. Patel

<b>(A2 continued)</b>	
Banana Investments Ltd.	Mr A.R. Olomi
Chemi and Cotex Industries Ltd.	Mr Anup L. Modha
Darsh Industries Ltd.	Mr H.C. Lal
General Tyre East Africa Ltd.	Mr Deven Lohani
Kibo Match Group Ltd.	Mr S.B. Nag
Kwanza Collection	Mr Lawrence Muze
MAC Group	Mr Y.M. Manek
Metal Crown Ltd.	Mr Shaukat Dalal
Premier Cashew Industries Ltd.	Mr Mushtak Fazal
Shah Industries Ltd.	Mr Himatlal D. Shah
Sunflag Ltd.	Mr Prosper V. Jincen
Tanzania Tea Packers Group	Mr G.C. Theobald
Tchibo Estates Ltd.	Mr Ralph Medoch
<b>Research Community</b>	
Research on Poverty Alleviation	Dr. Cyril Chami
Economic and Social Research Foundation	Dr. Suma Kaare
Economic and Social Research Foundation	Dr. Josaphat Kweka
Economic and Social Research Foundation	Dr. Beatrice Mkenda
Economic and Social Research Foundation	Dr. Flora Musonda
Economic and Social Research Foundation	Ms Umy Mwalimu
Economic and Social Research Foundation	Dr. Stergomena Tax
Tanzania Trade and Poverty Programme	Dr. Haji Semboja
University of Dar es Salaam	Prof. Francis Matambalya
University of Dar es Salaam, Economic Research Bureau	Dr. Gordon Mjema

## **Annex B: Interview Questionnaire**

### **B-1: Questionnaire for Government Officials, Researchers, Associations, NGOs, Donors<sup>45</sup>**

#### **1 General Questions concerning EPAs**

- Are you familiar with the EPA concept?
- In what way is your institution involved in EPA preparations?
- Will / should the extent of involvement of your institution change in the future?
- In what way are you personally involved in EPA preparations?
- Will / should your personal involvement change in the future?
- Have you or other staff in your institution participated in capacity building in this respect?
- Are you currently undertaking any activities regarding EPAs?

#### **2 Economic and Social Impact of EPAs on Tanzania**

- How have the economic sectors responded to trade liberalisation so far?
- What has been the impact of past trade liberalisation?
- What economic impact will an EPA have on Tanzania?
- Which sectors will be affected most by an EPA?
- In what way will these sectors be affected (positive / negative effects)?
- Will they be able to respond adequately?
- How could phasing and coverage of trade liberalisation accommodate the needs of Tanzanian economic actors?
- Are there currently any problems with market access (EU / region / general)?
- Has the EBA initiative improved market access to the EU?
- If preferences are not exploited, why not?
- What will be the fiscal impact of EPAs on Tanzania?

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45 Not all questions apply to all interviewees.

- Can Tanzania compensate for potential revenue loss?
- Is the potential impact of EPAs being discussed under the current fiscal reform?
  
- What will be the social (poverty-related) impact of EPAs on Tanzania?
- Which social groups will be affected most?
- In what way will these groups be affected (positive / negative)?
- How can the most vulnerable groups be protected from a negative impact?

### **3 National Co-ordination and Preparations of EPA Negotiations**

- Which institutions are involved in the preparations of EPA negotiations?
- How do these institutions work together? Is there a co-ordination mechanism between the ministries?
- What should a co-ordination mechanism look like?
  
- Where do you see major deficits in preparations and co-ordination?
- Is trade capacity effectively utilized?
- Does Tanzania make use of funding provided for capacity building?
  
- Which of the national authorities are responsible for regional integration initiatives?
- How do these national authorities work together with the regional integration initiatives EAC and SADC?
- Has Tanzania defined interests at the regional level and how are these enforced?
- Is Tanzania willing to give a greater role to the regional integration initiatives in the negotiation process?
  
- How is Tanzania participating in the ongoing EU-all ACP negotiations?
- How are the national authorities working together with their representatives in Brussels and Geneva (WTO)?
- Whom do the representatives in Brussels and Geneva report to?

- Does Tanzania make use of the ACP Secretariat's expertise? How?
- How are the negotiations prepared for?
- Who are the actors involved in the preparations for the negotiations?
- How does Tanzania determine its national and regional interests?
- Has Tanzania defined its national and regional interests?
- How could Tanzania strengthen its negotiation capacity?

#### **4 Involvement of New Actors**

- Who are the actors involved in the preparations for the negotiations?
- How does Tanzania define its national and regional interests?
- Has Tanzania defined its national and regional interests?
- Which ministries are responsible for the preparations for EPA negotiations?
- How do these ministries work together? Is there a co-ordination mechanism between the ministries?
- If not, how could you image such a mechanism?
- Does Tanzania make use of the funding provided by the PMU for capacity building?
- How could Tanzania strengthen its negotiation capacity?
  
- How do the national authorities work together with the regional integration initiatives EAC and SADC?
- How does Tanzania represent its interests on the national and regional level in the EAC and SADC?
- Is Tanzania willing to give a greater role to the regional integration initiatives in the negotiation process?
  
- How is Tanzania participating in the ongoing negotiations?
- How are the national authorities working together with their representatives in Brussels?
- Does Tanzania make use of the ACP Secretariat's expertise? How?

**B-2: Questionnaire for Private Enterprises**

- What products do you produce?
- Are you currently exporting to any foreign country?
- To which countries do you export?
- How much of your output do you export?
- What share to which country?

If you do not export, why not?

Do you face any obstacles to potential / current exports?

- Which obstacles are you currently faced with ? (RoO, SPS, tariff escalation, red tape, packaging, local authorities, other)
- How could these obstacles be overcome?
- Do you think that other enterprises are faced with the same problems?
  
- Are any inputs for your enterprises imported?
- Where do these inputs come from?
- What percentage of your inputs is imported?
- What percentage is imported from which country?
- Are your imported inputs subject to tariffs or any levies?
- If you export, do you make use of duty drawback?
- If not, why not?
  
- Do you face competition from foreign producers? (foreign or domestic?)
- Who are these competitors and where do they produce?
- Do they produce the same products as you or do they produce substitutes?



- Do you think further trade liberalisation would increase competition from foreign producers?
  
- Were you affected by past trade liberalisation?
- In what ways?
- How have you responded?
  
- What do you expect of the customs union with Uganda and Kenya?
- Are you taking any measures to deal with the new trade regime?

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- What would be your policy interests in the establishment of the customs union?
  
  - Have you ever heard of the EPA concept?
  - Have you ever been invited to any information workshop on the new EU ACP trade agreement / Cotonou?
  - What are your interests in the trade negotiations with the EU?
  - How are you participating in policy formulation currently?
  - What organisation represents your interests towards the relevant government institutions and has it informed you about the new EU ACP trade agreement?
  
  - Are you familiar with the EPA concept?
  - In what way is your institution involved in EPA preparations?
  - Will / should the extent of involvement of your institution change in the future?
  - In what way are you personally involved in EPA preparations?
  - Will / should your personal involvement change in the future?
  - Have you or other staff in your institution participated in capacity building in this respect?

## Annex C: The General System of Preferences of the EU in Comparison with the EPA Concept

Table C: The General System of Preferences of the EU in Comparison with the EPA Concept										
Preferential Trade Arrangement	Beneficiaries	EU-Rational	Market Access	Reciprocity	Phasing of liberalisation	Combination with Trade-related Aid	Potential Impact on:			
							Fiscal Revenue	Regional Integration	Regional Markets	
<b>EBA</b>	LDCs	Development; Reputation	Cumulative only among LDCs, Extensions possible	Unilateral elimination of tariffs and quantitative restrictions, except on arms and ammunition	No	Already in place (protocols until 2009) <sup>46</sup>	No	None	Potential conflict between DCs and LDCs belonging to a joint customs union	Potentially positive
<b>GSP</b>	All preferred trading partners	Multilateral trade liberalisation Market access for European producers	Non-cumulative Extensions possible in neighbourhood of EPA, EBA, Euro-Med	Unilateral Non-negotiable coverage of tariff lines to a larger extent than MFN	No	Already in place, review expected in 2004 Subordinate to WTO regulation, negotiations currently underway	No	None	Neutral, but potential conflict between DCs and LDCs	Potentially positive

46 Duty-free access will be granted to LDCs from January 2006 on for bananas, from July 2009 on for sugar, and from September 2009 on for rice.

Table C: (continued)

		Market Access		Reciprocity	Phrasing of liberalisation	Potential Impact on:			
Beneficiaries	EU-Rational	Rules of Origin	Coverage			Fiscal Revenue	Regional Integration	Regional Markets	
ACP 78 (+ SA <sup>47</sup> )	Historical relations Secure political influence WTO compatibility Improve market access for EU exporters to ACP-countries	Full cumulation Product-specific	Negotiable coverage of current tariff lines Reductions based on historical trade Potential exemptions in sensitive sectors such as Agriculture bilateral	Substantially all trade (approximately 90%) Special and differential treatment to be agreed on	Implementation 2008 – 2020 + ? Potentially inbuilt flexibility for extending implementation phase for LDCs	Yes However, linkages to EDF funded projects and programmes yet unclear	Yes, considerable Depends on import share of EU imports and demand elasticities	Positive if objective to deepen ongoing processes can be achieved Conflicts arising from multiple memberships of African countries	Both diverging and fostering elements Depends on propensity for trade creation and diversion
<b>Economic Partnership Agreement</b>									

47 SA has an FTA with the EU. Egypt, though not an ACP country, is a likely partner in the EU's Euro-Med Agreement.

## Annex D: Methodology of Comparative Static Analysis for Fiscal Impact Estimation

For our estimate of the revenue impact of an EAC-EU EPA we make use of comprehensive data collected by the Tanzania Revenue Authority, which provides import data at the 8-digit level of the Harmonised System (HS) by country of origin. This high level of disaggregation enables us to calculate the average revenue collected for each product and trading partner in a specific fiscal year. The latest available data is for fiscal year 2001/2002, which we use as the base year for our calculations.

In order to assess the revenue impact of an FTA between the EAC and the EU, we proceed in two steps. First, we estimate the trade creation and diversion anticipated in connection with an East African FTA, and then, in a second step, we use the resulting trade flows to estimate the trade creation and diversion generated by an FTA between the EAC and the EU, following the methodology of Gitu et al. (2003).<sup>48</sup> However, our approach differs from previous attempts to assess the revenue impact of such FTAs, which mostly focus on nominal tariffs presumably applied to imports into Tanzania. For our estimate of the accruing revenue loss we use not nominal tariff rates but the amount of import duty actually collected on each product. In addition, we calculate the average tax effect accruing to VAT, excise duties, and sales tax<sup>49</sup> on the respective imports. We in this way seek to take into account the substantial revenue loss due to official as well as unofficial tax exemptions in Tanzania (cf. Rajaram 1999:15).

To estimate the respective volumes of trade creation for Kenya and Uganda caused by an EAC FTA, we first compute the average tariff  $t_{i,j}$  collected on product  $i$  from each trading partner  $j$ . This average tariff reflects the effective price change  $\tau_{i,j}$  for imports from each of the two preferred trading partners for the case that tariffs on imports of good  $i$  are eliminated. Trade creation  $TC$  for good  $i$  imported from country  $j$  is then computed using the formula

$$TC_{i,j} = M_{i,j} * \epsilon_{d,i} * \tau_{i,j} / (1 + t_{i,j}),$$

where  $M_{i,j}$  denotes current imports of product  $i$  from country  $j$ , and  $\epsilon_{d,i}$  the elasticity of demand for good  $i$ .

In order to quantify the amount of trade diversion away from non-preferential partners  $k$  towards EAC partners, we calculate the combined average tariff  $\xi_i$  on imports of  $i$  from Uganda and Kenya (weighted with the cif value of current imports from each country). This average tariff reflects the average price change on imports of  $i$  that accrues to tariff elimination towards the preferential trading partners. The corresponding diversion of imports of good  $i$  away from supplying country  $k$  towards preferential trading partners is then given by

$$TD_{i,k} = M_{i,k} * \epsilon_{s,i} * \xi_i / (1 + t_{i,k}),$$

where  $M_{i,k}$  denotes current imports of product  $i$  from country  $k$ , and  $\epsilon_s$  denotes the elasticity of substitution between different suppliers of good  $i$ . Imports thus diverted from each non-preferential partner  $k$  are then split up between preferential partners  $j$  according to their share of current imports of the respective product (cf. DeRosa 2002:13). In case the product is currently not imported from any of the preferred partners, we assume that this

48 This two-step approach is adopted in order to make our results comparable with previous studies examining the fiscal impact of tariff elimination within the EAC.

49 Although the sales tax was presumably replaced by a 20 % VAT in July 1998, the data show collected sales tax for HS codes 27100031 (aviation kerosene), and 87112000 (motorcycles with reciprocating engines of capacity 50-250cc) imported from Saudi Arabia.

specific product cannot be supplied by them in the short run, and consequently that no trade diversion can take place.<sup>50</sup> In this case  $\xi_i$  cannot be derived and  $TD_i$  is set to zero.

Since no reliable estimates for either of the respective elasticities can be obtained, we follow Gitu et al. (2003) in assuming constant values of 0.5 for  $\epsilon_d$  and 2 for  $\epsilon_s$  for all goods. However, since these values are rather arbitrary, we run the same computation, doubling and halving  $\epsilon_d$  and  $\epsilon_s$ , in order to test the sensitivity of our results with regard to this important assumption.

The change in public revenue corresponding to the changes thus derived in effective tariffs and trade flows is then computed by applying not only the new tariff regime to the estimated imports but also the average tax effort (i.e. excise, VAT, sales tax, and any other surcharges recorded in the data) corresponding to each product and country of origin, thereby taking into account the differential treatment accorded to different products from different trading partners by central government taxes, as revealed by the data.

To obtain estimates of the revenue impact of an FTA with the EU in the second step, we proceed in exactly the same manner, allowing for trade diversion away from both EAC countries and other non-EU partners based on the estimated trade flows under an EAC FTA.

It must be stressed that in our estimate we resort to some elementary simplifications. First, we do not take into account the changes in import tariffs following the establishment of a common external tariff (CET) in the EAC, with rates that will presumably differ from the ones currently prevalent in Tanzania. The reason we adopt this simplification is that because we use the average tariff rates actually collected instead of nominal ones, we would have to know what this average would be in the case of the CET. Calculating the effect of the CET with its nominal rates would in this case inevitably underestimate the true revenue effect, because this would be tantamount to the assumption that all exemptions were eliminated at the same time.<sup>51</sup> The second major simplification we resort to is that we do not take dynamic effects into account, and assume that when an FTA is established, all tariffs are eliminated immediately. This does not reflect the fact that the Cotonou Agreement envisages a transitional period of up to twelve years for implementation of full reciprocity between ACP economies and the EU. Any such gradual adjustment of tariffs may, however, lead to quite different results and remains to be examined in future research. Finally, basing the calculations on trade flows of a single year is not unproblematic, as these can be expected to evolve quite dynamically over the coming years. However, despite these major simplifications, we believe that in employing this method we should be able to get some realistic idea of the magnitude of the revenue impact to be expected from an EPA between the EAC and the EU.

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50 It should be noted that this – among others – is an important simplification we resort to in our calculations.

51 One solution to this problem would have been to assume that the same average share of nominal tariff rates collected will be collected under a CET. However, for this purpose we would have needed the actual tariff rates as well as those envisaged under the CET for each HS code. Unfortunately, these data were not available at the time of writing.

