

THE EXPERIENCE OF EC PROVIDED EPA RELATED ADJUSTMENT SUPPORT: THE REALITY OF EC “AID FOR TRADE” SUPPORT IN THE BLNS

Overview of the Experience and Major Lessons¹

Introduction

The debate on the need for EPA related adjustment support and how this relates to EU commitments in the area of “aid for trade” is intensifying.

The EU Council has recently recognised that increased and more effective aid for trade is needed to support ACP countries in reaching their development objectives and taking full advantage of trading opportunities which EPAs will provide. It has committed the Commission and EU member states to continue and strengthen their support in this area and to furthermore address trade related economic adjustments.

Aid for Trade to ACP Countries and EPA Support

9. The Council recognises that increased and more effective AfT is needed to support the ACP countries in their endeavours to use trade more effectively for reaching their development objectives, and to take full advantage of the increased trading opportunities including those provided by future EPAs. ... the Council underlines the need for the Commission and the Member states to ensure that a substantial share of their collective commitments to increase their trade related assistance to EUR 2 billion by 2010 will be devoted to the ACP countries. The Contribution of the Member States is additional to EDF resources.
10. Furthermore, in addition to trade related assistance ..., the Council welcomes the Member states' and the Commission's considerable level of on-going support to other categories of AfT, namely productive capacities and infrastructure. The Member States and the Commission are fully committed to continue and strengthen this support, and furthermore address trade related economic adjustment, in response to needs as prioritised by ACP countries. In this context, the Council stresses the potential of the new EU-Africa Partnership for Infrastructure.
11. The Council invites the Commission and the Member States to support in a collective effort, within the above commitments, and as an immediate priority, the implementation of EPA related reform commitments. The preferred delivery mechanisms for this support will be existing nationally and regionally owned financing mechanisms.
12. The Council underlines the importance of ownership and reaffirms its support for identifying and mainstreaming demand-driven and needs based trade related priorities, including EPAs, in the ACP countries own plans and strategies. The definition of these priorities by ACP countries and regions in their development strategies is an essential step to enable the EU Member States and the Commission to take these needs into consideration and respond to them effectively in the development assistance programming.
13. The Council underlines that increased efforts to ensure coordination and monitoring of all assistance along the principles of aid effectiveness are needed....The Council emphasises that the institutional arrangements to be agreed for EPAs should include an appropriate and transparent monitoring mechanism to follow the impact of EPAs in ACP Countries and regions. This would allow effective monitoring of the development and trade challenges from the start of implementation of the EPAs.

Aid for Trade Conclusion of the Council, 16 October 2006 14018/06

Against this background what has been the experience to date of EC support to EPA related adjustments in those ACP countries where moves towards free trade are most advanced, notably, Botswana, Lesotho, Namibia and the Swaziland (BLNS)? These four ACP countries,

¹ This paper is extracted from a larger piece of research undertaken in association with ICCO and implemented by the European Research Office.

as a result of their membership of the Southern African Customs Union, are already 6 years into the implementation of free trade area agreement with the EU. With the EU-South Africa free Trade, Development and Cooperation Agreement agreed in 1999 and implemented from 2000, the European Commission was able to make early start at delivering EPA related adjustment support in the BLNS. What then has been their experience of European Commission EPA related adjustment support and what lessons can be drawn?

Research commissioned by ICCO and implemented by the European Research Office has sought to review this experience using the typology of EPA impacts developed by the Commonwealth Secretariat. This Commonwealth secretariat study identified 4 broad clusters where EPAs will have economic effects, and where experience suggests adjustment support will be needed. These four areas are:

- *fiscal adjustment;*
- *trade facilitation and export diversification;*
- *production and employment adjustment;*
- *skills development and productivity enhancement.*

This provides the framework for assessing EC support to EPA related adjustment needs in the BLNS.

Fiscal Adjustment Support

With regard to fiscal adjustment support an early start was made in 1999 with the revision of **Swaziland's** 8th EDF National Indicative Programme to include €5.6 million in support to fiscal restructuring. This four year programme was intended to diversify the revenue base away from an excessive dependence on customs revenues (around 50%), by introducing a comprehensive VAT system and a unified revenue authority, which would more effectively collect taxes. Unfortunately by the end of the programme in June 2006 the moves to establish both a unified revenue authority and VAT system were some four years behind schedule and dependence on customs revenues was set to rise from 54% in 2004/05 to 62% in 2006/07. This was occurring against a background of anticipated 23% fall in revenues from customs duties by 2012.

In June 2006 the EC disengaged from providing support to fiscal restructuring in Swaziland, despite a public commitment in the context of the EPA negotiations that “*the EU would help those affected negatively to adjust*”. This decision was taken on the basis that although the programme had been “*relevant to the problem identified*”, its impact had been “*very marginal*” and it was considered to have been “*over ambitious*”. Given that the Commonwealth Secretariat study estimated that Swaziland would require €60 million over 10 years in fiscal adjustment support, the question arises was the support extended actually commensurate with the needs in Swaziland?

There is a relationship between the scale of the fiscal adjustment challenge faced, the appropriate level of “ambition” in EC programmes of support, and the scale of funding required to support the fiscal adjustment process. This needs to be seen against the background of IMF assessments that in moving away from trade based taxes most developing

countries have been able to recover “*no more than 30 cents of each (trade tax) dollar*”² lost as a result of trade liberalisation.

This experience suggests a need for a major intensification of EU efforts in support of fiscal adjustment in the coming years, with a much more sustained and consistent engagement with all stages of the reforms being introduced, if as a result of EPAs, a large hole is not to be left in the state budgets of African governments.

In **Botswana**, small levels of targeted EC support to the actual implementation of VAT reforms and the creation of a single revenue service proved very effective, since the Government of Botswana had in place a framework (backed by its own financial resources) which was able to effectively direct and utilise this EC assistance. A key factor in the relative success of EC support in Botswana was **the use of aid delivery modalities which allowed the recruitment within the SACU region of staff with direct experience of VAT administration and VAT reform**. This ensured the provision of high quality and highly relevant technical assistance inputs at the various stages of the process of **designing, introducing and implementing** a new system of VAT collection.

This experience in Botswana when compared to the experience in Swaziland **brings into question the main tool for aid delivery which the EC generally uses, namely, externally sourced programme management units**. The experience in Swaziland suggests these units can be poorly integrated with local structures and largely ineffective, with scarce development assistance resources being used to little long term effect.

In **Namibia** in 2003 the Government and European Commission worked up a €8 million programme for support to public financial management reform. However in 2004 it was reported that under the NIP funding was “*insufficient to cover other programmed interventions... and the funding of the newly identified Public Finance Management Support Programme*”. The programme was therefore shelved, despite a growing dependence on customs revenue transfers (up to 43% in 2006/07 from 30% in 1997/98) and the impending decline in customs revenue collection as a result of the implementation of the EU-South Africa TDCA from 2012 onwards.

This strongly suggest a need for a dedicated, adequately financed instrument for extending support to fiscal adjustment in ACP countries entering into EPAs.

Currently there is no indication that the EU is willing to contemplate the creation of such an instrument, despite the creation of no less than 9 other “horizontal instruments” (as they are known) using over €2 billion of EDF funding since 2000.

In the most customs revenue dependent country of the BLNS, **Lesotho**, the EC, despite a commitment to the provision of macro-economic adjustment support, has singularly failed to engage effectively with the revenue diversification challenge faced in Lesotho. The provision of support in this area has been left to the UK Department for International Development (DFID).

Fortunately the 5 year £4.05 million DFID supported programme proved highly effective. A Lesotho Revenue Authority was established, VAT introduced and tax collection greatly

² See “Dealing with the Revenue Consequences of Trade Reform”, Background paper for Review of Fund work on trade, prepared by the Fiscal Affairs Department, International Monetary Fund

enhanced. The initiation of simple reforms to harmonise the Lesotho VAT system with that of South Africa yielded a 204% increase in revenues collected in one year alone.

“Horizontal Envelops” Financed from EDF resources Since 2000

- major debt relief initiatives (HIPC) (€460 million);
- the Global Fund for HIV/AIDS, Malaria and TB (€432.5 million);
- The Africa Security Facility (€250 million);
- The Water Facility (€247 million – with a further allocation of €250 million pending);
- Private Sector Enabling Environment Facility (€20.0 million);
- Micro-Finance Framework Programme (€15 million);
- Malaria Vaccine Trials (€7 million);
- The Energy Facility (€ 250million);
- Infrastructure facility (€60 million in grants €60 million in loans)

Yet with customs revenue payments to Lesotho, as with the other BLNS countries, set to fall considerably from 2012 onwards, the need for further support is self evident. If the EC were to make commitments in this area however, the experience to date suggests that these could best be implemented through the **existing and highly effective DFID supported programme**.

Indeed, a strong case can be made for **DFID playing a lead role in public finance management reform and revenue diversification and enhancement efforts** throughout the BLNS, *coordinating* financial assistance from the EC and other member states, in order to ensure **a consistent approach and sustained engagement** with this critical issue across the affected countries.

Looking to the wider lessons of the BLNS experience, elsewhere in the ACP, particularly in Africa, consideration might needs to be given to **linking the implementation of tariff elimination commitments in “revenue sensitive products” to the successful implementation of revenue diversification programmes**, with tariff elimination commitment on revenue sensitive products being made, but their implementation only being triggered upon the successful implementation of revenue diversification programmes.

There is a precedent for linking the implementation of a specified schedule of tariff elimination commitments to the adoption of measures in a related area, in the provisions of the EU-South Africa TDCA dealing with the elimination by the EU of tariffs on fisheries imports from South Africa. Here, while a schedule of tariff reductions is included in the agreement, its implementation will not take place until such time as South Africa has concluded a fisheries access agreement with the EU. Linking the implementation of tariff elimination commitments to the implementation of policy measures in a related area is thus an established part of EU free trade agreements.

The adoption of this kind of “conditional tariff offer approach” to revenue sensitive products would greatly reassure least developed African countries that the EC and EU member states are taking seriously their concerns and are open to exploring practical solutions to the problems and challenges faced.

Trade Facilitation and Export Diversification Support

The **Swazi** and **Namibian** experience in the field of trade facilitation and export diversification under their NIPs illustrates the problems which arise through the extensive use of European consultancy firms in the mobilisation of technical assistance support. The lack of commitment, appropriate expertise and often local knowledge, can fundamentally undermine the value of the support extended. This is particularly the case where the staff deployed in-country are recruited on the basis of lowest cost and earliest availability considerations rather than quality concerns.

One BLNS official informally claimed that the only long term benefit from a 3 year €1.2m Trade Promotion programme were the two office computers left behind! Probably two of the most expensive office computers outside of the NASA space programme! In Namibia, the Government consistently turned down the candidates for the long term trade advisors post as to inexperienced or simply not good enough. This profoundly undermined the value of a €3.6 million Trade and Investment Development Programme.

This experience raises the issue of the appropriateness of the EC model for aid delivery in this area and raises the question as to whether there should not be a lead member states coordinator in this complex area, with a mandate to ensure the quality of the assistance extended reaches the required level.

In this area there is also a major mis-match between what the EC spends its money on and the immediate challenges facing BLNS exporters in dealing with Europe. By far the most important trade facilitation issue relates to meeting EU food safety standards. Failure to comply with EU standards in the coming years could see the EU market closed to BLNS food and agricultural exports, generating major export revenue losses for these economies. Targeted programme of assistance to supporting private sector investment in meeting EU standards (as financed internally within the EU) and developing public sector capacities to guarantee compliance are urgent priorities. Studies suggest initial investments of around €14 million are required to enhanced government food safety control capacity, with further long term support being extended to their operation and periodic upgrading.

This suggest a need for a dedicated facility to extend support to ACP countries in meeting EU food safety standards and ensuring EU standard compliance and control capacity at the national level. Such an instrument needs to be adequately financed and easily accessible (initial requirements €200 million). Unfortunately, there is no indication that consideration is being given to the creation of such an instrument.

Trade/Production Adjustment Needs

Stragglng the issue of trade and production adjustment needs, there is an urgent requirement to assist preference dependent ACP countries in getting to grips with the challenge of preference erosion. The value of a range of traditional trade preferences enjoyed by ACP countries are being eroded by the combined effects of CAP reform, multilateral trade liberalisation and bilateral EU free trade agreements. A coherent policy response, backed up by appropriate instruments of assistance, is urgently needed to assist ACP countries in getting to grips with the challenge of preference erosion.

In terms of trade relations with the EU, in the BLNS the two sectors most severely affected are the beef sector (Namibia, Botswana and Swaziland) and sugar sector (Swaziland). In terms of wider trade relations the textile sector, following the ending of the multi-fibre agreement should be added (Lesotho and Swaziland).

Examples of policy responses where additional financial support will be required include shifting the pattern of BLNS beef production for export to the EU away from serving the undifferentiated “necessity purchase” component of the EU market (where prices are stagnant or in decline) to increasingly marketing their products into the “luxury purchase” component of the EU market, where prices are buoyant and rising. Making such a transition however, given the human resource constraints faced, will require targeted programmes of assistance to ease both the human resource constraint on adjustment and the financial constraint on adjustment.

Unfortunately no consideration is being given to how concretely the EC can assist in getting to grips with this challenge, despite the advanced stage of the implementation of the free trade area agreement with the EU which embraces the BLNS, the large scale income losses for BLNS exporters flowing from the process of CAP reform and the growing competition faced on EU markets from advanced developing country exporters.

The EC has instruments available, but EU aid deployment procedures do not allow there effective deployment in support of “time sensitive” adjustment processes. While the dogmatic preoccupations of the EIB mean that grants from EU member states are on-lent to BLNS smallholders at interests five times those nominally available under the Cotonou Agreement, and which EU based multinationals commonly enjoy where investing in ACP countries.

There is a need to **review the terms and conditions for on-lending from these types of facilities, so that loans on-lent to small and medium sized enterprises more closely reflect the range of lending instruments nominally available under the Cotonou Agreement and the rates of interest nominally charged by the EIB.** Equally there is a need to ensure that where **grants** from EU member states are used to finance on-lending facilities, **the grant should be extended at the country level, creating locally managed revolving funds** and avoiding the exchange risks currently associated with taking out loans from the EIB, which can bump up considerably the interest rates charged local small and medium sized enterprises.

In a context of profound inefficiencies in the provision of banking services in ACP countries, there is no legitimate development justification for taking **grants from EU member states** to deploy as **loans through the EIB**, on which **market related interest rates are then charged**, since this simply services to replicate inefficiencies in the banking sector and does little to foster a dynamic production response to EPA induced economic changes.

Employment Adjustment and Skills Development

This is probably the most neglected area of EC assistance and yet, given the important link between formal sector employment and working ones way out of poverty, it is an area which has the greatest direct bearing on poverty alleviation. While the EU is putting extensive funding into the development of education and training facilities, no consideration is being given to establishing “bridging programmes” to help workers retrenched as a consequence of EPA related production adjustments gain access to these training opportunities. Equally while the EC is putting considerable resources into micro and small enterprises development again no consideration is given to “bridging programmes” to help retrenched workers access these facilities to take up new business opportunities.

This is a major shortcoming of EC support in Swaziland where in the last two years over 1/3 of the sugar sector workforce has been retrenched in preparation for the income losses arising from EU sugar sector reform. This has seen 3,500 workers lose not only their jobs but their families lose their access to housing, health and education provision in sugar growing areas. Urgent transitional measures are required to address the worst consequences of employment adjustment under the impact of EU policies.

Unfortunately EC programming and aid deployment procedures will mean that, although additional money has been allocated for support to sugar sector adjustments in Swaziland, none of this money will find its way to operational programmes on the ground in Swaziland until at the earliest mid 2009. This is profoundly undermining the credibility of what is otherwise a generous EU response to production/employment adjustment needs.

The EC will need to move beyond its “business as usual” approach in the face of the profound adjustment challenges confronting ACP countries as a consequence of the conclusion and implementation of EPAs. There are no shortages of practical suggestions as to what can and should be done to respond effectively to the immediate needs of retrenched workers, however there is a profound and growing frustration over the inability of the EC to deliver in practical terms the kind of support needed. This is resulting in the demobilisation of local stakeholders, whose effective engagement in adjustment processes is essential for their successful implementation.

The Political Dimension of EC “Aid for Trade” Support

Part of the early promising EC response to the adjustment needs of the BLNS was the €6 million “Economic Integration Support Programme for the BLNS”. Established in February 2001. This €6 million programme was comprehensive in its scope and through its successive phases hoped to get to grips in a systematic way with the regional implications of the implementation of the EU-South Africa TDCA.

Phase 1 of the project, which was to last three years, was seen as the preparatory phase and was to involve:

- analysis of the adjustment issues arising from trade liberalisation;
- the preparation of activities to take advantage of new opportunities;
- an analysis of coping measures for the necessary adjustments.

Under Phase 2 of the programme (which would require additional funding) it was envisaged that activities would be initiated to:

- assist the private sector to enhance competitiveness;
- design appropriate transitional budgetary support programmes (including in the case of least developed Lesotho the provision of direct budgetary support).

Under Phase 3 of the programme (which again would require additional funding) it was envisaged that provision would be made for the financing of transitional budgetary assistance programmes and the further implementation of any activities arising from phase II.

Unfortunately this programme was never operationalised, since the financing proposal contained a provision stipulating that for the programme to become operational BLNS governments must “concur” under the SACU agreement with the provisions of the EU-South Africa TDCA. This required the governments of the BLNS countries to fully accept the application of the EU-South Africa TDCA to the whole territory of the Southern African Customs Union, without any consultations on the consequences of this bilateral EU-South Africa agreement for the trade rights and privileges which BLNS countries had acquired since 1975 as members of the ACP Group. Namibia consistently refused to give in to this blatant political arm twisting to “concur” under the SACU Agreement without any attempt being made to address genuine BLNS concerns.

As a consequence, in 2005 this programme was converted into an institutional support programme for the SACU Secretariat. The initial concept of a multi-phased programme to comprehensively address the regional consequences of the implementation of the EU-South Africa TDCA and support fiscal and economic adjustment was **quietly abandoned**, despite the acute relevance of this approach to getting to grips with the challenges posed by EPA/CAP related adjustment requirements.

The fate of this project highlights the willingness of the European Commission to give priority to its wider policy concerns (in this case securing broader regional endorsement of the approach to free trade implicit in the TDCA) to the neglect of the country and region specific concerns. This is most worrying in a context where the EU is renewing and refocusing its free trade area policy on faster growing areas of the world and where the commitment is to a more “activist” approach to market opening abroad.

According to Commissioner Mandelson this openness agenda is “*no longer simply a question of tariffs*”, but increasingly about internal policies pursued in partner countries including “*poor protection of intellectual property right and patents, closed markets for services and investment; unfair state intervention which distorts prices and fair competition*” and “*public procurement markets that remain closed to fair competition*”³. These are areas where the ACP are profoundly reluctant to enter into region to region agreements with the EU until such time as they have in place national and regional policies, legislation and effective institutional structures.

³ Speech Trade Commissioner Mandelson in Berlin 18th September 2006
<http://europa.eu/rapid/pressReleasesAction.do?reference=SPEECH/06/507&format=HTML&aged=0&language=EN&guiLanguage=en>

With the EC likely to vigorously pursue this agenda in **ALL** free trade area negotiations, there are concerns that genuine ACP interests and concerns will be subordinated to this wider EU policy agenda, with the programming of the 10th EDF being used to “encourage” ACP governments to sign on to economic partnership agreements, about which they have profound reservations.

Close public scrutiny will be required to ensure that the “engineered convergence” of 10th EDF programming and the final stages of the EPA negotiations is not misused by the European Commission.