

THE REALITIES OF EC "AID FOR TRADE" SUPPORT IN BOTSWANA, LESOTHO, NAMIBIA AND SWAZILAND



LESSONS FOR THE EPA NEGOTIATIONS

Introduction

The European Union is currently negotiating six Economic Partnership Agreements (EPAs) with 77 countries in Africa, the Caribbean and the Pacific for implementation from 2008. These so-called ACP countries comprise some of the least developed countries in the world.

Overall, the EU is treating these EPAs as reciprocal free trade agreements. However, in recognition of the asymmetries between the EU and the ACP countries and likely significant adjustment costs, the EU is engaging in trade-related aid and adjustment programmes.

New research commissioned by ICCO on the experience of four developing countries in Southern Africa - Botswana, Lesotho, Namibia and Swaziland, who are already engaged in the process of implementing a free trade area agreement with the EU: the EU-South Africa Free Trade, Development and Cooperation Agreement (TDCA)-, indicates that such programmes in their current form fall dramatically short of their stated objectives.

EPAs and development

EU relations with the ACP countries are currently governed by the Cotonou Partnership Agreement, offering unilateral trade preferences to the ACP countries as the weaker partner in the agreement.

The Cotonou Agreement will expire in 2008. The EU is set

to replace the Cotonou preferential treatment system with across-the-board and WTO-compatible reciprocal market access under the EPAs, with the stated objective to assist the ACP countries in a process of sustainable integration into the world economy.

The EU's far-reaching market opening agenda comprises the trade in raw materials, agricultural products, non-agricultural goods, and services and addresses areas including investment, government procurement, intellectual property rights, customs procedures and development assistance.

The reciprocal trade relations envisaged in the EPAs will require significant adjustments on the part of the ACP countries as the weaker partner in the negotiations. The likely adverse development impact of reciprocal market access between such highly asymmetric partners as the EU and the ACP countries, in particular the least-developed among them, continues to be highlighted by civil society organisations and ACP Trade Ministers alike.

The need for adjustment support

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.

New ICCO research, addressing the debate on the need for EPA-related adjustment support and how this relates to EU commitments in the area of Aid for Trade and implemented by the European Research Office, identifies four broad clusters where EPAs will have economic effects on the ACP-EU trade relationship and where experience suggests adjustment support will be needed. These four areas are based on a typology developed by the Commonwealth Secretariat¹:

- Fiscal adjustment
- Production and employment adjustment
- Trade facilitation and export diversification
- Skills development and productivity enhancement

The BLNS experience

ICCO uses the experiences of the BLNS countries – Botswana, Lesotho, Namibia and Swaziland – as a case study. The BLNS are well positioned to highlight ACP experiences to date of EC support for EPA-related adjustment.

The BLNS are among the ACP countries where moves towards free trade are most advanced. As members of the Southern Africa Customs Union, these four countries are already six years into the implementation of a free trade area agreement with the EU: the EU-South Africa Free Trade, Development and Cooperation Agreement (TDCA), agreed in 1999 and first implemented from 2000. The free trade paragraph of the TDCA foresees in a programme of tariff reductions, culminating in the elimination of all import duties on 86% of all EU exports to South Africa in year 10-12.

The analogy with the EPAs is clear. With the TDCA, the European Commission was able to make early start with delivering trade-related adjustment support in BLNS. The experiences from BLNS are thus highly valuable with regard to shaping EPA-related adjustment support.

Unfortunately, the EU's TDCA support programmes in BLNS with regard to the key clusters where the EPAs will also require adjustment support, as identified by ICCO - *trade facilitation and export diversification, fiscal adjustment, production and employment adjustment and skills development and productivity enhancement* – have largely failed to deliver for a variety of reasons relating to an insufficiently consistent and comprehensive commitment to development objectives.

The survey below analyses some of the major shortcomings of EU trade-related adjustment programmes in the clusters identified, and offers recommendations for improvement.

The failed experience of EC "Aid for Trade" support

Part of the early, promising EC response to the adjustment needs of the BLNS was the "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 adjustment issues arising from trade liberalisation; the preparation of activities to take advantage of new opportunities; an analysis of coping measures for the necessary adjustment.

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 2.

Unfortunately this programme was never operationalised, since the financing proposal contained a provision stipulating that for the programme to become operational, BLNS governments, under the Southern African Customs Union agreement (SACU), must "concur" with the provisions of the EU-South Africa TDCA.

This required the governments of the BLNS countries to unreservedly accept the application of the EU-South Africa TDCA to the whole territory of the Southern African Customs Union, without any consultations on its consequences for the trade rights and privileges which BLNS countries had enjoyed since 1975 as members of the ACP Group. Namibia for one consistently refused to give

¹ See the Commonwealth Secretariat Study "The European Development Fund and the Adjustment to Economic Partnership Agreements"

² Instead, in 2005 the programme was converted into an institutional support programme for the SACU Secretariat.

in to this blatant political arm twisting and absence of initiatives to address genuine BLNS concerns.

As a result, 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.² However, in each of the four clusters identified, valuable lessons can be drawn from its failure.

1. Fiscal adjustment support: a need for intensification and improved coordination

A key issue in moving from a system of preferences as under the Cotonou Agreement to reciprocal free trade arrangements is the need for developing countries to diversify their fiscal system and move away from the trade-based tax systems most countries currently rely on.

However, the fiscal adjustment challenges developing countries face, is daunting. IMF assessments indicate that in moving away from trade based taxes, developing countries have generally been able to recover “no more than 30 cents of each (trade tax) dollar³” lost as a result of trade liberalisation.

The experiences of Botswana, Lesotho, Namibia and Swaziland under the EU-South Africa TDCA indicate that a successful transition will require a major intensification of EU efforts in support of fiscal adjustment in the coming years, if - as a result of EPAs - a large hole is not to be left in the budgets of African governments.

A key issue is the EC’s main tool for aid delivery in this context, which relies heavily on externally sourced programme management units. Findings indicate that these units tend to be poorly integrated with local structures and largely ineffective. There is an urgent need for a comprehensive, adequately financed instrument for extending support to fiscal adjustment in ACP countries entering into EPAs.⁴ In addition, structured coordination of EC adjustment programmes is urgently required.

The lessons of the BLNS experience for other ACP countries, particularly in Africa, indicate that linking the implementation of tariff elimination commitments in “revenue sensitive products” to the successful implemen-

tation of revenue diversification programmes should be considered, 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.

Adoption of such measures would go a long way to 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. For to date, EU fiscal adjustment support in BLNS has been largely unsuccessful, with the single exception of Botswana.

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 framework was able to effectively direct and utilise this aid. A key factor here was the use of aid delivery modalities which allowed the recruitment of regional staff directly experienced in the areas where high quality technical assistance was needed.

In Swaziland, however, there is reason to question whether the support extended was actually commensurate with the country’s needs. A four-year programme to diversify the revenue base away from an excessive dependence on customs revenues (around 50%) by

³ 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

⁴ 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, where the EU has funding priorities.

introducing a comprehensive VAT system and a unified revenue authority which would more effectively collect taxes was set up in 1999, with the revision of Swaziland's 8th EDF National indicative Programme.

Some - 5.6 million was included in the programme in support of fiscal restructuring, a sum falling dramatically short of what was needed: a Commonwealth Secretariat study estimated that Swaziland would require - 60 million over 10 years in fiscal adjustment support.

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"*.

By the end of the programme in June 2006, the moves to establish both a revenue authority and VAT system were some four years behind schedule. Dependence on customs revenues increased from 54% in 2004/05 to 62% in 2006/07, even though, under the TDCA implementation scheme, revenues from customs duties were expected to fall by 23% in 2012.

Experiences from Namibia offer an equally bleak picture. In 2003, the Government and EC 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.

And in the most customs revenue dependent country of the BLNS - Lesotho - the EC has singularly failed to engage effectively with fiscal adjustment support altogether, leaving this field to the UK Department for International Development (DFID). Fortunately, the 5 year £4.05 million proved very effective. A Lesotho Revenue Authority was established, VAT introduced and tax collection greatly enhanced. The initiation of simple reforms to harmonise the Lesothan VAT system with that of South Africa yield a 204% increase in revenues collected in one year alone.

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. However, there would appear to be a case in Lesotho for EC support to fiscal adjustment (via public finance management and revenue enhancement support) to be deployed within the framework of the existing, effective DFID supported programme.⁵

2. Trade Facilitation and Export Diversification Support: failing allocation and misappropriation of funds

In this cluster and for the purpose of this summary, ICCO wishes to highlight two key points, both of which raise the two-fold question whether the EC model for aid delivery in this area is in fact appropriate, and whether increased coordination would benefit the quality of assistance reaching the required levels.

Firstly, ICCO's research highlights a fundamental mismatch between EC spending and the immediate

challenges facing BLNS exporters in their dealings with Europe.

There is a strong need for a dedicated adequately financed instrument (initial requirements – 200 million) for extending support to food safety compliance in ACP countries in the wider context of evolving EU-ACP trade relations, as by far the most important trade facilitation issue relates to meeting EU food safety standards. Failure

⁵ 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.

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 programmes of assistance to support private sector investment in meeting EU standards (as financed internally within the EU) and develop public sector capacities to guarantee compliance are urgent priorities. Studies suggest initial investments of around – 14 million are required to enhance the government’s food safety control capacity, with long-term support being extended to operational management and periodic upgrading. Unfortunately, there is no indication that consideration is being given to the creation of such an instrument.

Secondly, there is the related issue of the extensive use of European consultancy firms in the mobilisation of technical assistance support. The report flags a lack of commitment, appropriate expertise and (often) local knowledge, and staff recruited on a lowest cost and earliest availability basis rather than on the basis of quality concerns, which can fundamentally undermine the value of the support extended.

The Swazi and Namibian experience offer cases in point, with one Swazi official informally claiming that the only long term benefit from a 3 year - 1.2m Trade Promotion and International Trade Management programme was two office computers left behind (likely making them the two most expensive office computers outside of the NASA space programme!).

In the case of Namibia key issues related to the quality of assistance delivered arose. The position of long-term trade advisor was never filled, since the fees offered by the winning contractor to candidates to fill the post failed to attract candidates of a sufficient quality and experience to ensure that they would add value to the domestic process of trade policy formulation.

This profoundly undermined the value of a - 3.6 million Trade and Investment Development programme, throwing into question the value of the framework contract approach favoured by the EC to overcome its internal administrative constraints in terms of the quality of assistance delivered.

3. Trade/Production Adjustment Needs: the perverse impact of EIB lending

A key issue in the EPA negotiations is the need to respond to the erosion of the value of traditional trade preferences extended by the EU to African countries including the BLNS under the Cotonou Agreement. The BLNS countries have already begun to experience the acute implications of free trade under the TDCA.

To mitigate damaging trade effects under the current TDCA, there is a strong need to shift the pattern of BLNS 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 for the “luxury purchase” segment of the EU market, where prices are buoyant and rising.

Making such a transition, however, requires targeted programmes of (financial) support. The EC has instruments available, but EU aid deployment

procedures do not allow their effective deployment in support of “time sensitive” adjustment processes.

The European Investment Bank (EIB) uses the instrument of ‘Global Loans’, which are generally financed by grants provided by the EU member states, to provide support to small and medium sized enterprises through local financial institutions.

Unfortunately, within the EIB there is a general insistence that the operation of these Global Loan facilities should not undermine the functioning of local financial markets. In combination with the need to factor in exchange rate risks, this can lead to rates of interest charged on loans from this grant-financed facility equal to or in excess of the interest rates charged on loans from local commercial banks.

The dogmatic preoccupations of the EIB mean that grants from EU member states are lent on to BLNS smallholders at interest rates up to five times those nominally available under the Cotonou Agreement,

while EU-based multinationals do commonly benefit from these lower Cotonou rates when investing in ACP countries.

4. Employment adjustment and skills development: access and timing issues

This is probably the most neglected area of EC assistance and yet the one which has the greatest direct bearing on poverty alleviation, given the important link between formal sector employment and the opportunities to work one's way out of poverty.

Here the key learning points of BLNS's TDCA experience for EPA negotiation and implementation are that 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 gain access to these training opportunities.

Equally, while the EC is putting considerable resources into the development of small and micro-sized enterprises, again no consideration is given to "bridging programmes" to help redundant workers access these facilities to set up new business opportunities.

This is a major shortcoming of EC adjustment support in Swaziland, where in the last two years over 1/3 of the sugar sector workforce has been retrenched in preparation for the projected income losses arising from EU sugar sector reform. This has cost 3,500 workers not only their jobs, but also lost their families' 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. A key issue here is timeliness. Although the EC has allocated additional money to support sugar sector adjustments in Swaziland, EC programming and aid deployment procedures will mean that unfortunately none of this money will find its way to operational programmes on the ground in Swaziland until mid-2009 at the earliest. This profoundly undermines the credibility of what is otherwise a generous EU response to production/employment adjustment needs.

Conclusions: New EU 'activist' trade agenda set to eclipse development concerns?

According to the Cotonou Agreement, the EPAs should be development instruments to promote sustainable development, poverty eradication and smooth ACP integration into the world economy.

The BLNS EU-South Africa TDCA experience shows that the EC will need to move beyond its "business as usual" approach in the face of some of the profound consequences of adjustments underway in response to EU policy changes, if these professed objectives are to be effected.

There is a profound and growing frustration over the inability of the EC to deliver in practical terms on support commitments made, despite the abundance of practical suggestions as to what can and should be done. This is resulting in the demobilisation of local stakeholders, whose effective engagement in adjustment processes is essential for their successful implementation.

The fate of the "Economic Integration Support Programme for the BLNS" in particular highlights the European Commission's ready inclination 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, with a clear commitment 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".⁵

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. And not without reason. With the EC likely to vigorously pursue the abovementioned 'activist' market opening agenda in ALL free trade area negotiations, there are growing concerns that, in the EPA process, legitimate ACP interests and concerns will be increasingly subordinate to the priorities of the wider EU policy agenda.

Reduction of ACP economic vulnerabilities must be satisfactorily addressed before reciprocal market access can be considered.

⁶ 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>

The full report "Moving Beyond 'Business as Usual' – The BLNS Experience of EC EPA-Related Adjustment Support and the 'Aid for Trade' Debate" is available at www.icco.nl. Hard copies can be ordered from:

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