

# The Impact of the EPAs of the Cotonou Agreement on Trade, Production and Poverty Alleviation in the Caribbean Region

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Caricom/OECS and some ACP countries

## Background and Objectives

The objective of this research was to consider the potential impact of an EPA between the EU and the Caribbean, arising from the Cotonou agreement. The focus was on the possible impact of an EPA on trade, welfare and poverty in the small island economies of the Organisation of Eastern Caribbean States (OECS). The study largely focussed on three of the OECS islands – Dominica, St.Kitts and Nevis, and St. Lucia.

The research was composed of three parts:

1. Analysing Caribbean regional integration - based on descriptive statistics and on a more formal “gravity modelling” framework. A key part of the Cotonou agreement is the facilitation of the process of intra-regional integration among ACP countries in order to enable the greater integration of the ACP countries into the world economy via trade liberalisation and via the development of industries/sectors at the regional level. The intention is to increase efficiency and growth, and thus standards of living, all facilitated by the process of regional integration. This part of the research therefore considered the extent of regional integration, the scope for further integration and the possible impact of an EPA with the EU based on underlying descriptive statistics.

2. Building on the preceding, part 2 of the research evaluated via formal simulations the potential impact of EPA-induced liberalisation on trade, prices and welfare. In the process we also explicitly consider the issues of “substantially all” trade, and special and differential treatment in the context of the Caribbean.

3. We also considered the impact of the EPAs on poverty in the small island economies of the Caribbean, with a particular focus on Dominica, St Lucia, and St Kitts and Nevis. This part of the research involved translating the price changes derived from (2) in order to assess the impact of the price changes on poverty using household level data. The analysis focused on the impact on poverty of changes in import prices and primarily of the prices of food items figuring in the islands’ consumption baskets.

## Research Findings

Our analysis suggests the following:

- Most of the Cariforum countries have already achieved a fairly high degree of integration as part of the Caricom process, or as part of the OECS, and are continuing that process under the auspices of the CSME. Nevertheless, there are a number of exceptions, and derogations to these agreements with the explicit recognition of the special and differential treatment (SDT) of the LDCs. This serves to introduce intra-regional trade barriers, which limit the extent of integration in the region.
- Via the CSME the region is attempting to deepen the process of integration. This is rightly seen as being important in terms of increasing the competitiveness and flexibility of the region as it engages increasingly with the world economy. The success in terms of economic growth and prosperity, and in terms of enabling the integration of the Caribbean islands into the globalised world economy, will depend crucially on the de facto implementation of the CSME.

In cooperation with



- EPA induced preferential trade liberalisation by the Caribbean economies is likely to engender trade diversion and only modest amounts of trade creation and trade reorientation. This emerges both from a consideration of descriptive statistical indicators and from more formal modelling. The direct overall welfare impact is likely to be extremely small, or could be negative depending on government response to the potential concomitant fall in tariff revenue.
- For the OECS there is likely to be only a small decline in poverty from lower domestic prices arising from any EPA induced preferential trade liberalisation. The corresponding increase in living standards should be felt by all sectors of society, though slightly more for those who are poorer. The impact is likely to be small because of the relatively low importance of the EU in total imports and consumption, and due to the importance of food items in the islands' consumption baskets.
- EPA induced preferential trade liberalisation is likely to result in substantial losses of tariff (and hence government revenue), requiring national governments to establish alternative revenue sources and adjust expenditures.
- The direct welfare gains arising from EPA induced liberalisation are likely to be extremely small. This raises the question of the desirability of such an agreement, which is likely to depend on key features of the agreement itself, and also on developments in trade policy with third countries.
- In particular, more substantial welfare gains are likely to arise in the presence of either multilateral trade liberalisation, and/or through furthering the process of deep integration in both goods and services. Ideally therefore, it is important that any EPA induced trade liberalisation is pursued within a broader based multilateral liberalisation perspective, and that moves towards deeper integration within the EPA process and the CSME are also encouraged.
- The successful integration of the Caribbean economies into the world economy is more likely to be achieved with the successful implementation of the CSME. This is likely to enhance the flexibility of the region to respond to the changing nature of global competition, to encourage the exploitation of economies of scale, as well as to facilitate productivity improvements.
- There is mixed evidence to suggest a growing trend for intra-OECS and OECS-Caricom trade to be lower than intra-Caricom trade, and lower than trade between other comparable countries. While this could indicate the difficulties faced by the OECS in integrating both regionally and globally, there are also alternative plausible explanations. Prima facie, this does not necessarily provide further support for the special and differential treatment (SDT) of the OECS.
- Where there may be a case for SDT for the OECS economies it is important that any such policy identifies clearly the grounds for SDT and distinguishes appropriately between countries and their evolving needs over time. Introducing asymmetries in trade rules, or in tariff lists, is likely to increase distortions and inefficiencies. This has important implications for the political economy of trade policy for these countries, and may make it more difficult for the region to successfully integrate into the world economy.
- However, given the diversity across the countries of the Caribbean, agreement on a common list in order to satisfy the criteria of substantially all trade may be hard to achieve. This suggests the need for detailed planning and negotiation.
- A more satisfactory way of addressing the problem of different countries' development needs is not to introduce diversity in trade rules (either within Caricom/CSME, or within an EPA) but in the implementation of development assistance, aid and via appropriate regional funding mechanisms.
- This links back to the potential gains from signing an EPA, and thus to the extent and nature of development assistance and aid which may be provided to the Caribbean as part of the preferential liberalisation process. Development assistance and aid is likely to be important in helping to ensure lasting benefits from any EPA process.
- A central determining feature of the EPAs is the need by the ACP countries to liberalise their goods trade import regimes in order to ensure WTO compatibility. The key objective of this study was to focus on the potential impact of that liberalisation. In three ways this study does not purport to analyse the overall impact of an EPA. Secondly, we do not analyse the services sector which we recognise is important in the Caribbean region. Thirdly, we do not formally address the impact of changes in policy on long run rates of growth.

For further information on this research project, please visit:

EC-PREP website: [www.ec-prep.org](http://www.ec-prep.org)

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