EUROPEAN CENTRE FOR DEVELOPMENT POLICY MANAGEMENT
CENTRE EUROPÉEN DE GESTION DES POLITIQUES DE DÉVELOPPEMENT

Addressing the Fiscal Effects of an EPA

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Study conducted with the support of Irish Aid,
Department of Foreign Affairs

May 2007

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Acknowledgements

The authors are grateful to Paul Brenton, Comhlámh, Ger Considine and Colin Roche for their helpful comments. This study is a revised version of an earlier paper written for Irish Aid, whose financial support is gratefully acknowledged. The views expressed in this study are those of the authors only, and should not be attributed to ECDPM or the Irish Department of Foreign Affairs.

Acronyms

ACP	African, Caribbean and Pacific States
BLNS	Botswana, Lesotho, Namibia and Swaziland
CEMAC	Communauté Economique et Monétaire de l'Afrique Centrale
CEMAC+	CEMAC plus Sao Tomé & Principe and Democratic Republic of Congo
CARICOM	Caribbean Community
CARIFORUM	Caribbean Forum
COMESA	Common Market for Eastern and Southern Africa
CU	Customs Union
EAC	East African Community
EC	European Commission
ECOWAS	Economic Community of West African States
ECOWAS+	ECOWAS plus Mauritania
EPA	Economic Partnership Agreement
ESA	Eastern and Southern Africa
EU	European Union
FTA	Free-trade agreement
GATT	General Agreement on Tariffs and Trade
GDP	Gross domestic product
IA	Irish Aid
LDC	Least-developed country
SACU	Southern African Customs Union
SADC	Southern African Development Community
SAT	Substantially all trade
TDCA	Trade, Development and Cooperation Agreement
VAT	Value-added tax
WTO	World Trade Organisation

Revenue recovery has been extremely weak in low-income countries: they have recovered, at best, no more than about 30 cents of each lost dollar.

Baunsgaard and Keen (2005)

1 Introduction

The African, Caribbean and Pacific (ACP) countries are engaged in the most substantive reform of their trade regime. For more than three decades, the ACP countries have benefited from a generous preferential trade regime from the European Communities, under which most ACP products could enter the European markets without any restrictions.[1] With the signing of the Cotonou Agreement in 2000, the ACP countries and the European Union (EU) agreed to set new trade arrangements that would build on the regional integration process of the ACP and foster their integration in the world economy, in a way that promotes their development and contributes to poverty alleviation. This new ACP-EU trade regime should also be compatible with the prevailing rules of the World Trade Organisation (WTO).

It is on this basis that the ACP countries, configured on six self-determined regional groupings[2] and the EU began negotiations in September 2002 on Economic Partnership Agreements (EPAs), due to enter into force by 1 January 2008. These EPAs will be free trade areas (FTAs) between each of the 6 ACP regions and the EU, which aim to address both trade and trade-related issues. Hence, for the first time the ACP will have to open up on a reciprocal basis their markets to most EU products.

This trade liberalisation currently negotiated in the context of EPAs may be expected to have significant effects on the ACP economies. While EPAs should be designed to promote the development of the ACP countries and regions, they may have some serious negative side effects, notably in terms of adjustments to trade liberalisation. In particular, all ACP countries will lose fiscal revenues as a result of the elimination of customs duties on imports from most EU products under an EPA. For some countries, this loss of trade taxes could significantly reduce government revenues, hence limiting their public spending. This could in turn have drastic consequences on some low-income (often already highly indebted) countries and their ability to pursue effective social and development policies.

The purpose of this study is to discuss the fiscal implications of EPAs with reference to the ACP regional groupings. It is not possible for this study however to cover systematically all ACP countries. Instead, the study relies on examples and illustrations from a variety of countries.

The paper is structured as follows. Section 2 presents the importance of trade taxes as a source of revenue for developing countries in general and ACP countries in particular. In this context, Section 3 reviews the potential effects of an EPA on fiscal revenues and discusses some of the limits of these estimates. With the prospect of significant losses of fiscal revenues with the implementation of an EPA, Section 4 identifies several strategies to (partially) remedy this situation, aiming either at limiting the loss of trade taxes or compensate for these losses, through additional aid or a fiscal reform. Section 5 concludes.

[1] Initiated in 1975 with the First Lomé Convention, these non-reciprocal preferences have been renewed under the successive Lomé Conventions (I to IVbis) and a transitory period (2000-2008) under the Cotonou Agreement.

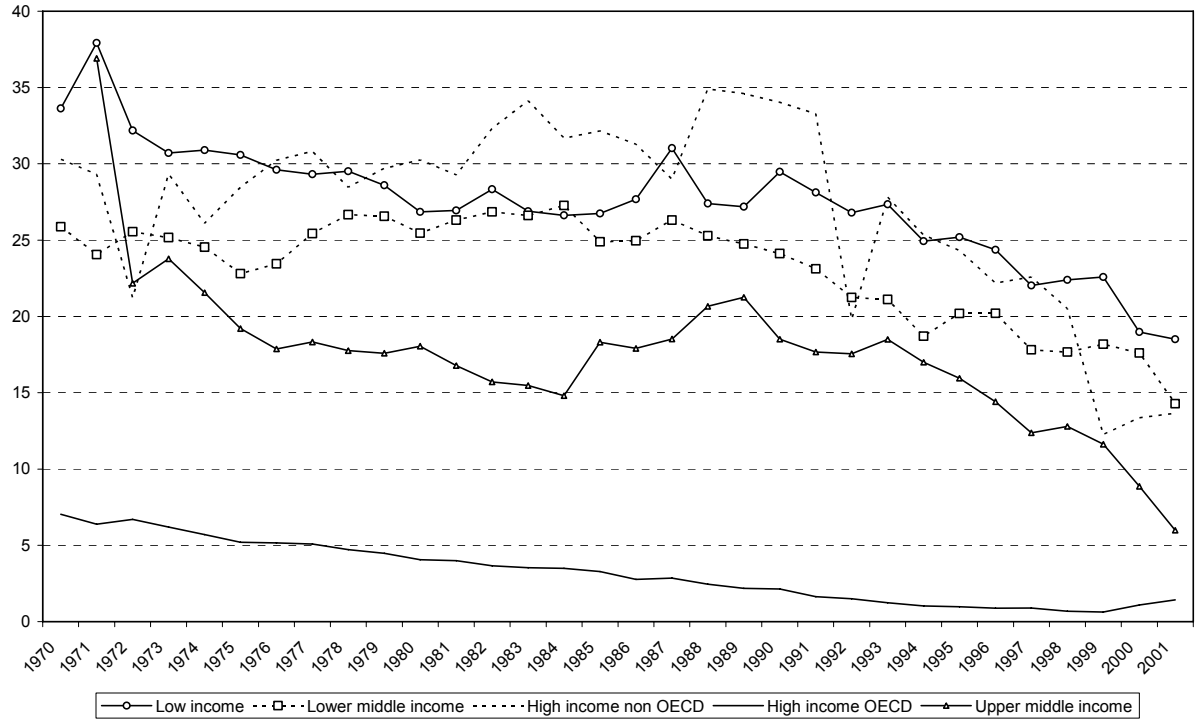
[2] West Africa (ECOWAS+), Central Africa (CEMAC+), East and Southern Africa (ESA), Southern Africa (SADC-), the Caribbean (CARIFORUM) and the Pacific ACP.

2 Trade taxes as revenue generators

Trade taxes remain significant in most developing countries, although there are great differences between countries and over time. While the share of import duties in fiscal revenues has declined over time for most countries, poorer countries continue to depend more heavily on trade taxes as a source of revenue, as illustrated in Figure 1. Regional disparities remain large, with customs duties constituting on average 25% of government revenues in Africa and 15% in Asia and the Pacific, African least developed countries (LDCs) have even experienced an increase on average of their dependence on trade taxes, as shown by Figure 2. These regional trends hide significant disparities among countries, as illustrated in Figure 3 for the Caribbean.

For ACP countries, the revenues generated through trade taxes still constitute an important part of public revenues, ranging from about one tenth in Jamaica to almost half of government revenue in the Bahamas, as indicated in Figure 4.[3]

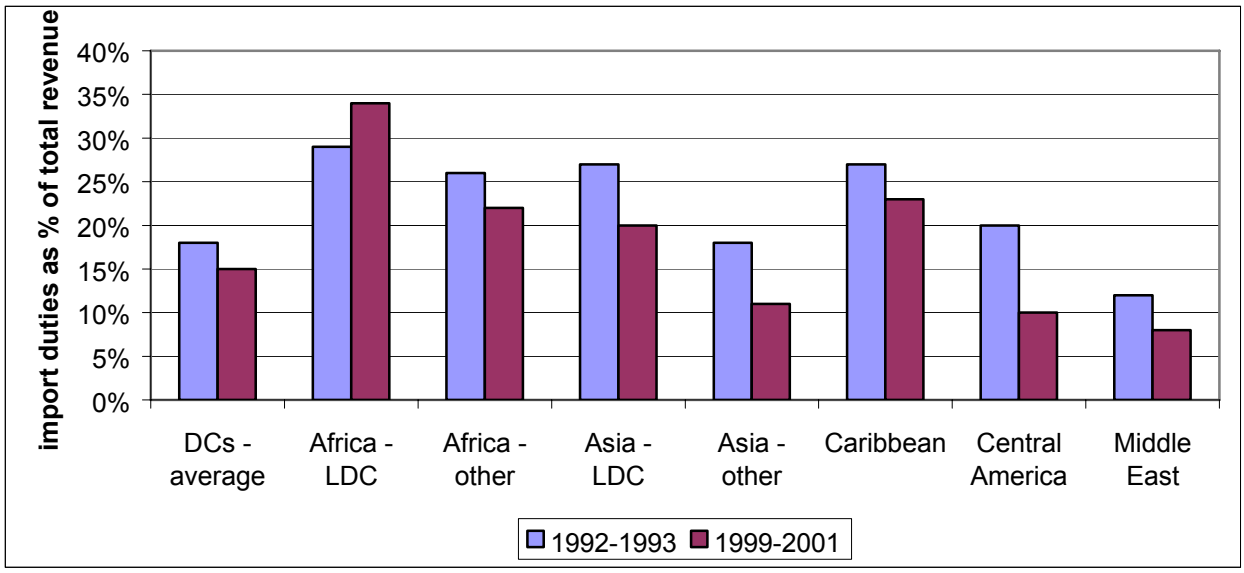
Figure 1. Reliance on import duties by income groups, 1970-2001



Source: Kowalski (2005).

[3] In comparison, trade taxes as a source of revenue is much greater than, where it does not even constitute one-thousandth of total revenues in Europe (World Bank, 2005).

Figure 2: Developing country reliance on duties for revenue



Source: Nathan Associates Inc.(2003).

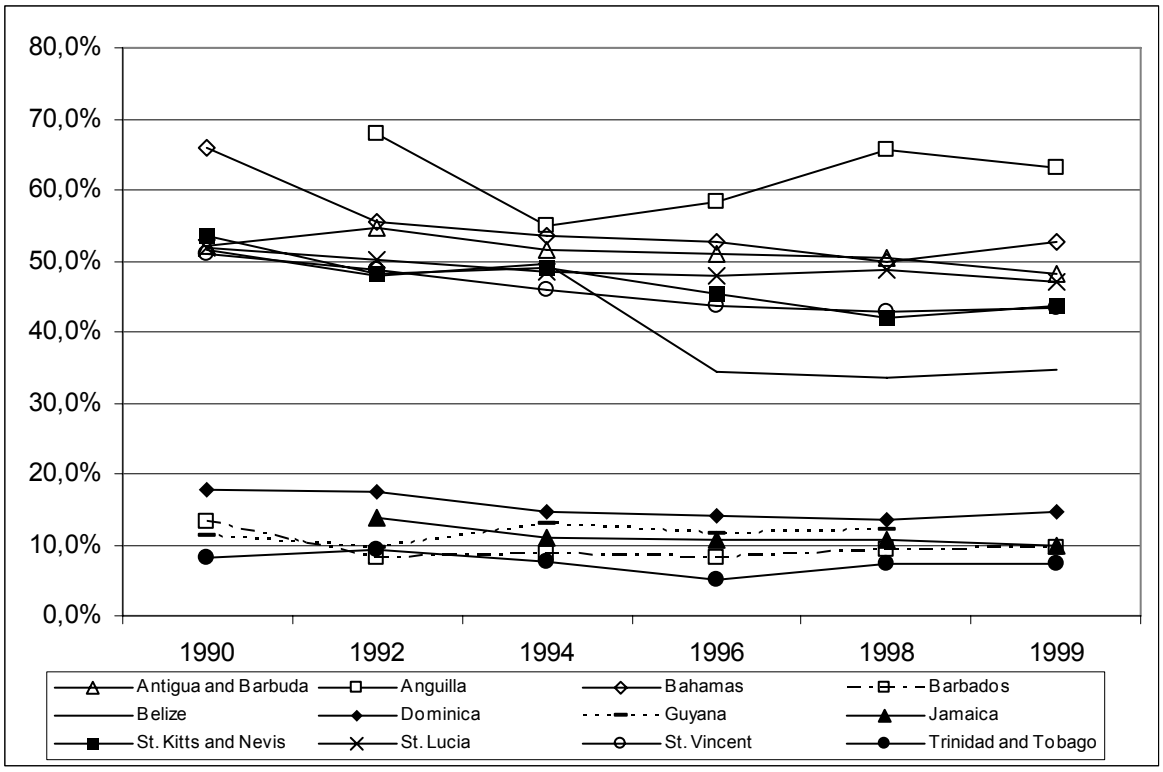
In general, the higher the dependence on customs duties is, the more significant the fiscal adjustment to be expected. The continued reliance on customs duties can in part be explained by the relative ease with which they are collected compared to more complex and politically more sensitive kinds of taxes such as income tax or value-added tax (VAT), which require different methods because they are, at least in part, collected inland instead of at the border. As a result, the reliance on trade taxes as a source of revenue seems to be larger in agricultural economies with low urbanisation, many mirco-businesses, a large informal sector and a weak and/or corrupt (tax) administration.[4]

Despite the higher dependence on trade taxes, many ACP countries have been liberalising their trade since the mid-nineties. Table 1 shows that many ACP countries have substantially liberalised their trade. The table demonstrates as well that the wave of liberalisation in the nineties was not restricted to the ACP countries. Other developing countries have liberalised their trade as well, often to a greater extent than the ACP countries.[5] Indeed, Figure 5 shows that the average level of protection remains important in many ACP regions.

Given the heavy reliance on import duties as a source of public revenue in developing countries, and particularly the poorer ones, the question thus is whether these countries are able to compensate the losses from trade taxes due to trade liberalization with revenues from other sources. Recent empirical evidence suggests that while tax revenues have continued to increase after trade liberalization in rich countries and have only been modestly affected in middle-income countries, they have significantly declined in low-income countries as the poorer countries have only managed to recover 30 per cent of the trade tax revenue lost as a result of trade liberalization through other taxes (Baunsgaard and Keen, 2005).

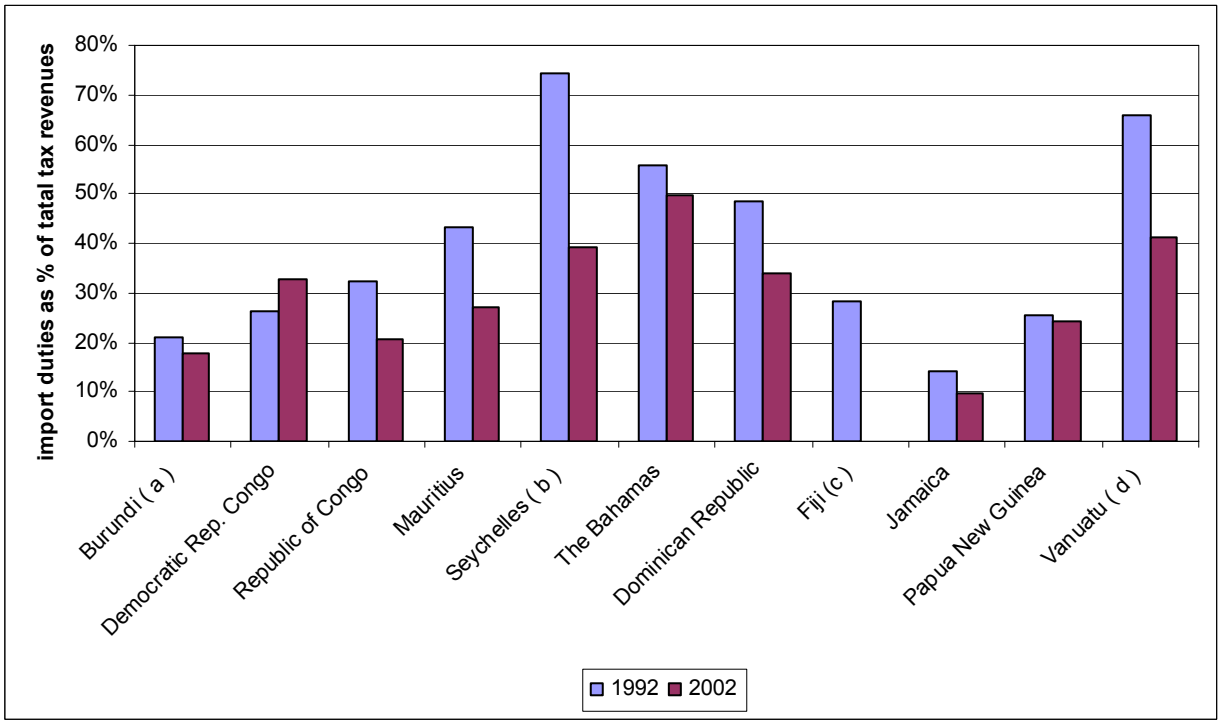
[4] See for instance Khattry and Rao (2002), Kowalski (2005), and Tanzi and Zee (2002).
[5] Note that the data should be interpreted with caution, however, since the reporting mechanisms vary and the quality of data may be poor.

Figure 3: The reliance on trade taxes for Caribbean countries in the 1990s



Source: Gasiorek, M. and L.A. Winters, 2004

Figure 4: Reliance of selected ACP countries on custom duties for revenue in 1992 and 2002



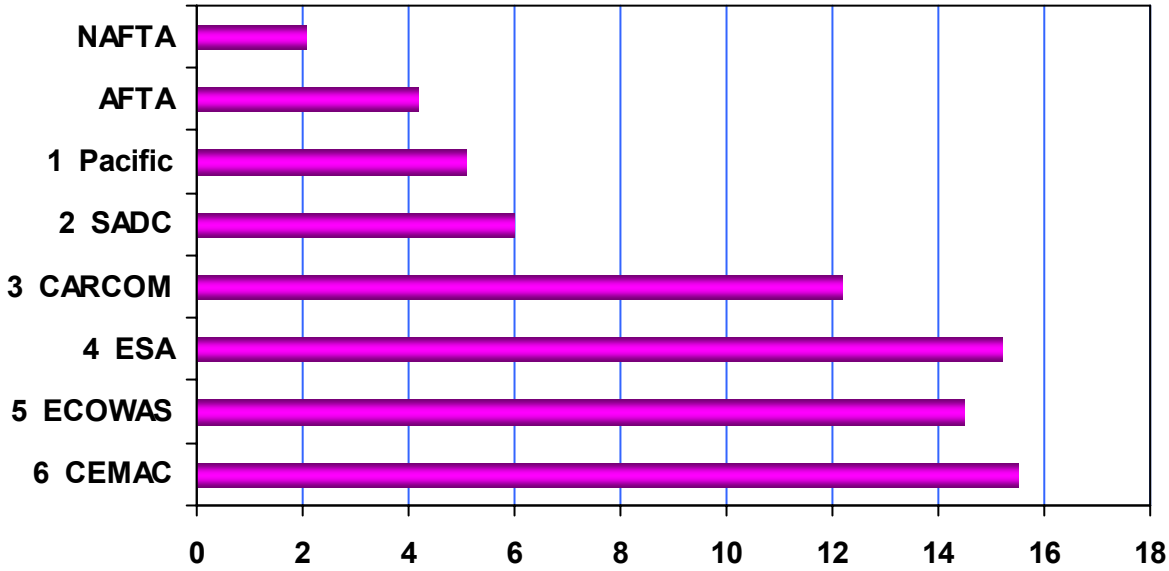
Source: World Bank Development Indicators 2005; (a) 1992 and 1999; (b) 1993 and 2002; (c) 2002 not available; (d) 1990 and 1999

Table 1: Average tariff rates in the mid 90s and early 2000s (in percentages)

	Mid-90s		Early 00s	
	avg. tariff	year	avg. tariff	year
Africa				
Ethiopia	18.2	1995	13.5	2002
Kenya	21	1994	13.3	2001
Mali	10.3	1995	10.6	2003
Mozambique	17.4	1997	10.2	2003
Tanzania	15.6	1993	8.6	2003
Uganda	16.8	1994	6.7	2003
Zambia	17.9	1993	10.8	2003
Other developing countries				
China	39.2	1993	11.4	2003
India	58.5	1992	32.2	2001
Philippines	23	1993	4.6	2003

Source: Clarke (2005).

Figure 5. Average MFN weighted tariffs



Note: EPA Tariffs are import-weighted at the country level, then weighted by GDP at EPA averages
Source: UN TRAINS, accessed through WITS; World Bank (2007).

This raises great concern about the potential negative fiscal impacts of the EPAs. The trade liberalisation carried out so far[6] by most ACP countries (see the previous figures and table 1) has been smaller than the liberalisation envisaged in EPAs, which will bring tariffs down to zero on "substantially all trade"[7] in the FTAs between the ACP regional groupings and the EU, and thus could eliminate most of the revenues so far generated by taxing imports from Europe. The fact that the EU is the most important trading partner of these countries only increases the potentially negative fiscal impact.

3 The potential impact of EPAs on fiscal revenues

The introduction of reciprocity in the ACP-EU trade relations has generated a lot of debate on the expected effects of EPAs on the ACP economies. Impact studies seek to provide estimates of these various effects. In 1998, to coincide with the start of the negotiations between the EU and the ACP on a successor agreement to Lomé IVbis, the European Commission (EC) contracted six studies for six ACP regions,[8] among them the regions relevant for IA programme countries in Africa: SADC and EAC. Since then, ACP governments have also contracted impact studies. Like the studies contracted by the EC, these studies have generally not been made publicly available either. Finally, a number of other impact studies have been carried out by independent experts, research centres and civil society organisations. The quantitative impact assessments tend to provide four categories of estimates: trade creation, trade diversion, consumer surplus/welfare, and the loss of fiscal revenues; only the latter estimates falls within the scope of this paper.[9]

As customs duties on most (i.e. 'substantially all') imports from Europe decrease to be ultimately eliminated with the full implementation of an EPA, fiscal revenues from trade will fall. This fall has two sources. First, EU imports that were previously taxed will enter ACP markets duty-free once an EPA will be in place, thus reducing trade tax revenues. Second, trade liberalisation under an EPA will make some EU products cheaper (since exempted from customs duties)[10] than products previously imported from other sources still subject to customs duties; this trade diverted from non-EPA origin to the benefit of EU imports also contributes to lower customs revenues. Overall fiscal revenue may be further negatively affected through two channels: (i) the income from a VAT on imports, levied on the total value of the imports plus the tariff, will be lower when tariffs are abolished; and (ii) income, corporate and indirect taxes (e.g. VAT) may yield lower revenues when companies go bankrupt and workers lose employment (i.e. reducing domestic production, savings, income and spending) as a result of greater competition from European producers (Mihretu, 2006).

However, trade liberalisation may not necessarily bring about a (significant) loss of fiscal revenue. Indeed, these trade-related negative effects on fiscal revenues can be counterbalanced by three other factors.

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[6] This liberalisation has generally taken place through multilateral negotiations as well as through lending-agreements with international financial institutions.

[7] Article XXIV of the General Agreement on Tariffs and Trade (GATT) require the parties to a regional trade agreement to eliminate trade restrictions on substantially all the trade between the parties over a reasonable period of time, normally within 10 years and up to 12 years in exceptional circumstances (see also Section 4.1).

[8] Although the studies commissioned by the European Commission in 1998 have never been made publicly available, a summary is provided by McQueen (1999) and Bilal (2002).

[9] A comprehensive overview of all four estimates for all African countries can be found in Bilal and Rampa (2006). See also Cali and te Velde (2006), and ECDPM and ODI (2006) for a critical synthesis.

[10] Note tha monopolistic conditions may prevent the price of some imports to go down in spite of the removal of duties, as foreign exporters, domestic importers or distributors may engage in anti-competitive behaviour and capture the benefits from narket opening by increasing the price of the imported products.

First, duties on EU imports do not have to be removed overnight, but over a transition period. The phasing down of a specific import duty may generate an increase of imports which, depending on the elasticity of demand for imports, may result in a temporary increase of tariff revenues.[11] However, countries with rather open markets, starting the liberalisation from already low rates of protection, may not experience such an increase in trade tax revenues from further liberalisation (UNECA, 2004). More generally, even for countries whose initial level of protection is high, there is always a point after which a lowering of tariffs would always cause revenues to fall; as the import duty falls to zero, the resulting trade tax revenue also tends to be eliminated. The important lesson though, is that the transition process does matter. The potential temporary increase of trade tax revenues may play a useful role in generating additional resources for financing adjustment measures to trade liberalisation and accompanying domestic reforms, including on fiscal matters.

Second, the fall of trade barriers in an EPA may generate positive competition and production effects, stimulating the economies of ACP countries and regions. This potential economic growth derived from trade liberalisation effectively broadens the domestic fiscal base (notably for income and consumption taxes), thus generating additional (non trade-related) fiscal revenues which may compensate for the loss of revenues from foregone trade taxes. It must be noted that dynamic effects are dependent on the pace, scope and level of trade liberalisation. The longer tariff reductions are phased out, as discussed in the paragraph above, the longer it will take for some dynamic effects to contribute to higher fiscal revenues[12]

Finally, the pressure on fiscal revenues due to the reduction of import duties may trigger domestic authorities to undertake substantive administrative and fiscal reforms, so as to improve the efficiency of tax collection and administration, often deficient in many developing countries, hence generating higher tax revenues.

Whether the loss of tariff revenues will prevail over the growth effects on fiscal revenues cannot be determined *a priori*, and thus remains a matter for empirical assessment.

3.1 Estimates on the fiscal impact of EPAs

The overall effects of an EPA on fiscal revenues have not yet been comprehensively assessed. Instead, empirical studies have generally focused on estimating the potential size of the loss of tariff revenues.[13] Tables 2, 3 and 4, as well as Annex A, provide an overview of some of the estimates on the potential fiscal impact of an EPA in selected ACP countries and regions.

The empirical estimates reveal that, overall, trade liberalisation under an EPA is expected to have a significant negative impact on fiscal revenues for most countries. Moreover, the size of the loss of trade taxes revenues varies significantly across countries and regions. Ethiopia, Tanzania and Zambia are examples of ACP countries whose fiscal revenues stand to be the most substantially affected by an EPA, in sharp contrast with Lesotho where the fiscal impact of an EPA should be marginal (see Table 2). At the regional level, the loss of fiscal revenues from an EPA might be particularly important in ESA and CEMAC (see Table 3). In addition, ACP LDCs are expected to experience larger losses than non-LDC countries; this is particularly worrying since LDCs usually already are less capable to carry out essential government services and will thus experience larger

[11] As each unit imported is less taxed, important demand increases and more united (taxed) are imported, which (depending on elasticities) may result in higher revenue from trade tax. See among others Ebrill *et al.* (1999) for a general discussion.

[12] Such argument is commonly advanced by donors to reject the idea of a full compensation mechanism for the loss of import duties resulting from trade liberalization (see also discussion in Section 4.2).

[13] See Section 3.2 for a discussion on methodological issues.

losses of revenues, making it disproportionately harder for LDCs to provide essential services.

While these results provide interesting insights, they should be interpreted with caution, as methodological considerations play a major role, as discussed below.

Table 2: Fiscal effects of EPAs on some African countries

	Revenue loss (mio USD)	%GDP	% customs revenue	% public revenue
Ethiopia	-55.1	-0.8	-15.4*	-4.9*
Lesotho	-0.3	0.0	-0.30	-0.10
Mozambique	-7.6	-0.2	-9.50	-1.5
Tanzania	-32.5	-0.3	-25.90	-2.30
Uganda	-9.5	-0.2	-18.2*	-1.8*
Zambia	-15.8	-0.5	-9.8*	-2.9*

Notes: * own computations by the authors using data of IMF Art IV consultations.
Source: UNECA (2005a).

Table 3: Fiscal impact assessments of EPAs on some ACP regions (in percentages)

	% customs revenue	**% public revenue**
ACP	-27.9	-5.8
ACP LDC	-37.7	-7.5
SADC-EU EPA	-19.4	-5.0
Mozambique	-23.0	-5.2
Tanzania	-30.0	-8.2
ESA-EU EPA	-42.2	-10.5
Malawi	-6.3	-1.4
Mauritius	-27.9	-9.3
Zambia	-22.0	-2.0
CEMAC-EU EPA	-72.0	-12.4
Central African Republic	-79.2	-14.9
Cameroon	-81.9	-8.2
Pacific-EU EPA	-2.4	-0.9
Papua New Guinea	-2.8	-0.6
Fiji	-1.4	-0.3
CARIFORUM-EU EPA	-13.8	-2.8
Guyana	-12.0	-2.6
St. Lucia	-15.0	-2.5

Notes: Unweighted averages; not all countries are included.
Source: Studies commissioned by the EC in 1998, as reported by Bilal (2002).

3.2 Methodology does matter

The extent to which these estimates can fluctuate is demonstrated persuasively by the different estimates for Tanzania (see Table 4). This might be partly explained by the use of different periods and the volatility of fiscal revenues overtime. In large, the differences in estimates for the same countries are largely due to differences in the methodologies adopted by the various studies.[14]

[14] For a brief discussion on impact studies on EPAs, see also Bilal and Rampa (2006, Section 4.1) and Cali and te Velde (2006).

Firstly, one of the variables used to calculate the expected revenue loss are the tariff lines. The models seem to have used two different kinds of tariffs, the bound and the applied tariff. The bound tariff is the maximum tariff rate a country can levy on a particular product under commitments made at the WTO. By contrast, the applied tariff is the level of tariff actually levied at the boarder by the country. In developing countries, these are often significantly lower than the bound tariffs.

When looking at the loss of customs revenues due to trade liberalisation, it is only tariffs effectively levied that matter, not the potential level of protection permitted by the multilateral trading system. The choice of tariff measure, effectively levied (i.e. applied) or potential (i.e. bound) tariff level, explains in part the different estimates presented in Table 4. UNECA (2005a) used applied tariffs while Tekere and Ndlela (2002) used bound tariffs; the higher bound tariffs arguably have led Tekere and Ndlela (2002) to overestimate the loss of customs revenues loss compared to those expected when the lower applied tariffs are considered.

Another aspect that should be taken into account is the effective rate of revenue collection. There are several reasons why all imports duties are not actually levied. Governments may decide to grant certain companies a tax holiday, exempting them from the obligation to pay import duties for a certain period. Various other trade tax breaks and exemptions may also be granted, such as in export-processing zones. Red tape, corruption and smuggling can also cause the revenue collection to be lower than expected.

Table 4: Comparison of estimates on the fiscal impact of EPAs

	in mio. USD		**% GDP***		**% customs revenue**		**% fiscal revenue**	
	A	*B*	*A*	*B*	*A*	*C*	*A*	*C*
Mozambique	-7.6	-29.2	-0.2	-0.7	-9.5	-23	-1.5	-5.2
Tanzania	-32.5	-146.6	-0.3	-1.5	-25.9	-30 / -73**	-2.3	-8.2 / -20**

Notes: * Computations, GDP data are from World Bank (2005);
** First figure relates to losses if Tanzania would join an SADC-EU EPA, second figure is the estimate if Tanzania were to join an EAC-EU EPA.

Sources: (A) UNECA (2005a); (B) Tekere and Ndlela (2002); (C) studies commissioned by the EC in 1998, as reported by Bilal (2002).

Busse and Großmann (2004) attempted to determine the collection efficiencies for West African countries and found collection efficiencies to range from less than 30% for Ghana to 90% for Senegal, as indicated in Table 5. The discrepancies between the estimates for revenue loss by UNECA (2005a) and Busse and Großmann (2004) are partly explained by the fact that UNECA did not take collection efficiencies into account, leading to an overestimate of revenue losses. Hence, the fiscal impact of an EPA may expected to be lower than reported if collection efficiencies are not taken into account (as illustrated in Tables 2 and 3).

Thirdly, estimates do not take into account growth (dynamic) effects of trade liberalisation on tax revenues. The limited availability of data and other methodological difficulties have led most quantitative impact assessments to restrict their estimates to the static effects, ignoring any possible dynamic effects. Contrary to revenue loss, which is estimated by multiplying the official customs *ad valorem* duty (applied or bound) with the value of imports, dynamic effects are concerned with the long-term changes as a result of the *de facto* widening of markets resulting from trade liberalisation. These include economies of scale, efficiency gains as a result of increased competition, improved investment climate, technological transfer and agglomeration effects. Dynamic effects can stimulate economic growth and hence increase the tax base. This may alleviate or possibly fully mitigate the revenue losses from tariff cutting. Since EPA impact

studies generally ignore dynamic effects, they only assess one limited dimension of the possible effects.

An additional shortcoming common to all quantitative assessments of the revenue loss is that they are based on 'blind' assumptions on the scope and speed of trade liberalization. With the EPA negotiations still underway and no precise shape of an agreement in sight, notably with regard to the products coverage and schedule for liberalisation, econometric modelling rests on bold scenarios, generally assuming full liberalisation by the ACP. However, the exclusion of sensitive products from the liberalisation list and longer transition period could significantly mitigate the loss of customs revenues from an EPA, as illustrated by Table 6 in the case of Ethiopia. Most empirical studies also ignore the broader trade policy context under which an EPA should take place. Notably, regional integration process and multilateral liberalisation will often accompany an EPA-related liberalisation.[15] Obviously, the choice of scenarios for liberalisation has a major impact on the size of the customs revenue effects to be expected.

Table 5: Collection efficiencies and their impact on revenue losses

Country	Collection efficiency[a] in 2001	Revenue Loss (mio. USD)	
		Busse[a]	UNECA[b]
Benin	77%	-27.6	-39.5
Burkina-Faso	61%	-17.5	-22
Cote d'Ivoire	69%	-82.9	-112.2
Ghana	29%*	-90.8	-193.7
Guinee-Bissau	38%	-2.2	-2
Mali	44%	-16.6	-33.1
Mauritania	73%	-11.8	-14.6
Niger	53%	-6.6	-20.5
Nigeria	80%*	-487.8	-426.9
Senegal	90%	-87.9	-80.2
Togo	77%	-12.9	-35.5

Note: * 2000.
Sources: (a) Busse and Großmann (2004); (b) UNECA (2005a).

Table 6: Fiscal effects of an EPA on Ethiopia

Scenarios	Loss of government revenues	
	Mio US$	%[a]
Full liberalisation of all imports from EU	55.1	4
Full liberalisation of agricultural imports from EU	7.4	1
Full liberalisation of industrial imports from EU	47.7	3.5
Full liberalisation of all imports from EU and COMESA	65.7	4.7

Note: (a) Fiscal loss as a percentage of the Ethiopian government revenues in 2002-2003.
Source: UNECA (2005b).

In particular, by assuming overnight liberalisation, most studies fail to take account of the gradual phasing down of trade barriers over time, which will affect the magnitude of revenue losses and their impact on government finances. The EPA schedule for tariff liberalisation and transition period have not yet been determined for any region. It might be reasonably expected though that substantive liberalisation will not take place for five to ten years (and perhaps even longer for some products), when revenue effects will start to kick in.

[15] Notable exceptions include Keck and Piermartini (2005) and UNECA (2005b).

In short, the above discussion on methodology suggests that the choice of bound instead of applied tariffs, and not taking into account collection efficiencies or dynamic effects leads to an overestimation of the potential customs revenue losses to be expected as a result of an EPA.

3.3 Interpretation of results

Rather than interpreting quantitative assessments literally, estimates of fiscal losses[16] are useful to acquire a sense of the magnitude of the expected effects and an idea of which countries or regions stand to lose more revenue compared to others. Some general trends may also be identified. For instance, it is expected that the more restrictive a trade regime is, the bigger the drop in fiscal revenue will be. Thus, Burundi, the Seychelles and Ethiopia, relative restrictive countries, as shown in Table 7, are expected to face larger fiscal revenue drops than Uganda, Malawi and Zambia, for instance. Other factors also seem to be critical: the fiscal revenue losses of trade liberalisation tend to be proportionally larger for small, landlocked and least-developed countries. Keen and Baunsgaard (2005) also observed that the ability to recover revenue after trade liberalisation and the level of national income are inversely related.

Although the extent of the trade tax revenue losses differ between countries and regions, the relative size of revenue shortfalls is significant for most countries concerned[17]. However, the fiscal impact of the EPA-related trade liberalisation should be considered in the more general fiscal context of the country concerned in order to judge the significance of the loss of trade taxes on the government's fiscal stance. First, as discussed at the beginning of Section 3, the EPA-related economic growth and institutional changes may potentially remedy the loss of trade tax revenues, at least partially. Second, the macro-economic environment plays a critical role. In particular, there is a relationship between trade liberalization, exchange rate and the effects on tax revenues, although the specific nature of the relationship has not been clearly identified empirically (Agbeyegbe *et al.* 2004; Adam *et al.* 2001; and Kowalski, 2005). Perhaps even more important, fiscal effects due to trade liberalisation are only one of the sources of fiscal shocks that a country is experiencing. In some instances, the impact might be marginal in countries experiencing a high volatility of fiscal revenues, with trade revenue losses constituting a relatively minor additional disturbance; in other instances, the loss of revenues from trade taxes might negatively tilt the balance of public finances, aggravating an already perilous state of fiscal revenues.

The concise overview provided by Annex 2 for some African countries indicates that the level of fluctuations of government finances greatly vary across countries. For example, Mozambique experiences greater volatility of expenditures than Zambia. Their responses to a loss of revenues from import duties may thus vary as well. Yet, these countries, like many other ACP countries, experience similar difficulties: they all have continuously faced deficits. Further reducing their financing capacity by EPA induced fiscal losses will limit their ability to support their development strategies, including in terms of positive redistribution and initiative in favour of the poorest segment of their population. For most countries, grants also constitute an important part of their revenues. In comparison, the estimated fiscal losses due to an EPA represent only a small portion of the support they receive from donors. This suggest that grants could play a significant role in facilitating the adjustments to the loss of revenues from import duties, an issue further discussed in

[16] As presented in Tables 2, 3, 4 and 6 and Annex 1.

[17] I may be suggested that the impact of the revenue losses may be lessened in case the level of government revenue is volatile from one year to the next. Such volatility, arising for example from government strikes or from a very rapidly growing economy, would have a much larger impact on revenues than the impact arising from trade tax losses. Adjusting to the loss of trade taxes would then less difficult since governments would be used to coping with differing levels of revenues.

section 4.2.

Table 7: Trade Restrictiveness ratings for selected ACP countries

	Tariff Rating (1-5)	Non-Trade Barriers Rating (1-3)	Overall Trade Restrictiveness Rating (1-10)
Angola	3	1	3
Burundi	5	2	8
Ethiopia	3	2	6
Madagascar	3	1	3
Malawi	2	1	2
Mauritius	3	2	6
Mozambique	2	1	2
Seychelles	5	3	10
Sudan	4	1	4
Swaziland	2	2	5
Tanzania	2	2	5
Uganda	2	1	2
Zambia	2	1	2

Note: All ratings come from the Trade Policy Information Database of the IMF. The higher the rating, the more a country restricts trade by levying high tariffs (left column) or imposing restrictive non-trade barriers (middle column). The right-hand column aggregates the first two columns; however, all three columns use different scales.
Source: Khandelwal (2004).

In any case, it is clear that, for EPAs to be politically acceptable and economically sustainable, a strategy to deal with the expected revenue losses is certainly necessary.

4 Possible strategies to address the fiscal impact of an EPA

With the prospect of significant loss of fiscal revenues with the implementation of an EPA, several remedy strategies can be envisaged to mitigate, at least partially, this negative effect. These include notably:

(i) the adoption of a trade liberalisation scheme that minimises the fiscal impact of an EPA;
(ii) an increase in financial aid to compensate for the negative fiscal impact of an EPA, notably through the provision of budget and balance of payment supports; and
(iii) the pursuit of fiscal reforms to replace trade taxes from other sources.

This section discusses each of these strategies in turn.

4.1 A strategy to minimise the fiscal impact of an EPA

In the context of an EPA, ACP countries will have to open up their markets to EU products. Yet, they may be able to do so without losing too much revenue from customs duties. ACP countries could enter a free trade agreement (FTA) with the EU while exempting from liberalisation the products that generate most trade tax revenue. How could this work?

One of the reasons for the introduction of reciprocity in the ACP-EU trade relation is the commitment to comply with WTO rules.[18] By negotiating EPAs, the ACP and the EU aim to conclude free trade agreements that will comply to Article XXIV of GATT 1994. One of the specificities of this rule is that it does not force parties to engage in complete free trade, but *only* requires, among others, that the parties eliminate trade barriers on "substantially all the trade" (SAT) within the FTA and that the transition period to establish the FTA should take only a "reasonable period of time", understood to be 10 years or longer (12 years) in exceptional circumstances. Thus, not only the FTA should not be put in place overnight, but some products might be exempted from free trade.

Another specificity of GATT Article XXIV is that, with no jurisprudence in place, significant ambiguities remain as to its interpretation, notably regarding the coverage of an FTA (i.e. how to determine SAT)[19]. The interpretation of the EU is that an FTA should lead to the elimination of at least 90% of the total value of trade between the parties to satisfy the SAT requirement. In addition, this 90% coverage threshold should be understood as an average, thus allowing for asymmetric liberalisation between the parties. Assuming balanced trade, this would mean that if the EU would liberalise (around)100% of its trade from the ACP[20], ACP countries would only have to eliminate trade barriers on 80% of the value of its imports from the EU, with the possibility thus to exclude 20% of so-called *sensitive* products from liberalisation under an EPA. One way to limit the fiscal impact of an EPA would thus be to include in this 'exclusion basket' the products that generate most customs revenue.

Note that in practice, some ACP regions like the Caribbean and West Africa experience a deficit in their trade balance with the EU, suggesting they would have to liberalise more than 80% of their trade within an EPA, whereas others like Southern Africa and the Pacific are net exporters towards the EU and thus could liberalise less than 80% of imports. Based on this observation, Claude Maerten (2004), head of the ACP Unit at DG Trade of the EC, provided rough estimates on the percentages of imports from the EU each ACP region would have to liberalise to satisfy the 90% average SAT criteria, presented in Table 8.[21]

Table 8: Trade liberalisation required in an EPA by ACP regions according to the EC

EPA Regions	Value of trade
Caribbean	83%
West Africa	81%
East and Southern Africa	80%
Central Africa	79%
Southern Africa	76%
Pacific	67%

Source: Maerten (2004).

[18] Non-discrimination is one of the core principles of the WTO. The current ACP-EU trade relationship, which grants the ACP preferential treatment compared to other developing countries, is therefore in disagreement with WTO rules. The WTO members agreed to turn a blind eye (the so-called "waiver") to this WTO-incompatible trade relationship until the end of 2007, to allow the EU and the ACP the chance to negotiate a new trade relationship which is in line with WTO principles.

[19] See Mathis (2002) for a comprehensive discussion, Mavroidis (2005) for a discussion on the application (or lack of it) of GATT Article XXIV, and Onguglo and Ito (2003 and 2005) for a discussion in the context of the ACP and EPAs.

[20] By doing so, the EU would match its Everything-but Arms initiative, whereby the EU already grants duty-free access to its market to all products from LDCs (after expiration of transition periods for some products).

[21] Were the ACP to adopt a lower SAT average, the impact of an EPA on the loss of custom revenues would also be reduced. Note though that the lower the SAT criteria adopted, the more likely the compatibility of an EPA with WTO rules will be challenged under the WTO dispute settlement mechanism.

Stevens and Kennan (2005) have used these conditions to identify a simple method/ instrument by which ACP countries can minimise the fiscal losses arising from EPAs, while complying with WTO obligations on FTAs. They suggest that ACP governments exclude the 20% or so (see Table 9) of products facing the highest tariff lines, assuming that these are the most sensitive products. In other words, an ACP country can simply rank its imports by decreasing order of tariff level and simply exclude the "top" 20% or so of imports with the highest tariff lines. Imports of these products from the EU will be excluded from the EPA, thus allowing ACP governments to continue levying tariffs on these most sensitive products in terms of revenue. As for the remaining 80% or so of the products, they will have to be included in the EPAs, but ACP governments can delay the loss of revenue by backloading liberalisation of the remaining sensitive products towards the end of the transition period. Naturally, the longer the transition period, the more gradual the loss of fiscal revenue will be.

Following the Stevens-Kennan methodology and using the data assembled by the Institute of Development Studies (IDS), it is possible to estimate the extent to which selected ACP countries may be able to retain the revenues from customs duties. The technique and results are presented in Annex A. In short, these rough estimates suggest that, were these countries willing to liberalise their trade in a way that minimise loss of customs revenues, Jamaica could retain 90% of its fiscal revenues, Uganda could retain nearly three quarters and other countries could keep approximately half of the current customs proceeds.

The extent to which the fiscal impact for the countries would be minimised is dependent on the extent to which countries have liberalised their trade before the EPA will take effect; the more liberal a trade regime is prior to an EPA the lower revenue shortfalls will be as a result of an EPA. Also, the lower the marginal tariff, the lower the shocks to affected sectors will be. Note that the marginal tariff, defined as the highest tariff that will eventually be abolished as it will be included in the EPA, can arguably also be an indicator of the competitiveness of national industries. In Jamaica, Papua New Guinea and Uganda the marginal tariff is relatively low (0-15%), while in Tanzania and Ethiopia it is relatively high. Ugandan, Jamaican and Papua New Guinean industries may therefore face smaller adjustment processes than industries in Tanzania or Ethiopia.

Such a strategy to minimise the fiscal loss of an EPA is likely to be advocated by the Ministry of Finances in each of the country concerned. Revenue collection is its core task, and trade taxes are generally levied for income generation purposes rather than trade policy instruments. The importance of the Ministry of Finance to the functioning of the government usually ensures it is one of the most dominant departments in government, even vis-a-vis the Ministry of Trade and Industry on trade matters. Therefore, a fiscal loss minimising approach is likely to constitute an attractive option for many ACP governments.

However, this strategy entails severe shortcomings. First, such a strategy may not be feasible for all countries. The EPA negotiating process is ultimately intra-regional, as ACP countries must adopt commonly agreed regional positions. To minimise fiscal losses, each country must determine its own list of products to be excluded and/or backloaded. However, countries within the same EPA grouping often have different tariff structures or trade patterns, and hence will want different products to be excluded and/or backloaded. As EPA groupings are large (comprising up to 15 countries), countries will most likely have to make numerous compromises, such as having to include in an EPA many products they would want to be excluded. This is confirmed by Stevens and Kennan (2005) who have tested the regional overlap of products and concluded it is rare. The harmonisation of national lists into one regional list may therefore offset a large part of the fiscal benefits initially anticipated by the ACP countries. The harmonised list may entail so little benefits for each country, or distribute the expected fiscal benefits so unevenly among regional partners,

that it could seriously undermine national support for a common strategy on EPA within the region. The more divergent national trade regimes are in terms of tariff schedules and trade patterns, the larger the concessions are required at the national level and thus the more difficult it is to reach a regional consensus, thus eroding a regional strategy to minimise fiscal losses from an EPA.[22]

A second weakness of this approach is that 'rules of thumb' calculation may prove incorrect and thus ineffective in limiting the potential negative fiscal effects of an EPA. Exclusion lists based on customs revenues can only be based on simple static analysis. As mentioned in Section 3.2, the *de facto* widening of markets as a result of an EPA will also bring about dynamic effects which will influence the patterns of trade. Thus, even when a country manages to get its most 'profitable' imports excluded from the EPA changes in the pattern of trade may render the list obsolete over time, as the patterns of trade and domestic competitiveness will change: today most income generating imports may be replaced tomorrow by other imports, which will be included in the EPA. This outcome is even more likely as transition periods are longer (over 10 or even 12 years) and the tariff schedule backloaded.

Yet, the main shortcoming of the fiscal revenue minimising strategy is that it leaves out any trade and industrial policy considerations. By selecting products to be excluded or backloaded solely on the basis of the revenue they generate through customs duties, countries exclude any strategic and development thinking about trade liberalisation. Product exclusions, which for instance could be used to shelter infant industries or economically and socially sensitive products, are now solely used to stabilise revenue collection.[23] It would be a missed opportunity to engage into meaningful trade policy reforms as well as necessary fiscal reforms.

It may be concluded that the fiscal approach has an intuitive appeal. It is relatively simple to compile the list of products to be excluded and, if successful, countries may be able to lessen the revenue losses from an EPA, at least in the short run. However, the essentially regional character of the EPA negotiations *de facto* limits the ability of each country to ensure that national exclusion lists that would minimise fiscal losses be adequately integrated into a regional position. Moreover, trade patterns are dynamic and such revenue-based exclusion lists are unlikely to remain accurate, and thus effective, overtime. But the most important deficit of this strategy is its narrow focus on revenue stabilisation and exclusion of other strategic considerations. It is thus recommended that countries which would be inclined to adopt this approach make sure that other policy considerations, such as development and poverty reduction, are also taken into account when the exclusion list is compiled.

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[22] In order to sign an intra-customs union agreement, the ACP regions will need to adopt a common external tariff and install a supra-national entity (Stevens and Kennan, 2006). In most ACP regional groupings, this is highly unlikely to happen in time for the conclusion of an EPA, due by the end of 2007. As a result, some ACP states might be inclined to pursue national tariff reduction schedules and exclusion lists with the EU, departing from the regional approach. However, these countries would then face the risk that the products they have excluded and were included in neighbouring countries will enter their country duty-free anyway as exports from the neighbouring FTA-members. Therefore, the lists will need to be largely harmonised regionally, irrespective of the degree of integration of the region, or complex rules of origin will need to be agreed, which would undermine regional integration.

[23] The infant industry argument suggests that emerging national industries need time to become internationally competitive and could therefore benefit from temporary protection. Countries may also wish to protect sectors that may not be great customs revenue generators, but which keep relatively many people out of poverty by providing employment. For instance, it is likely that some agricultural products fit this description by providing a livelihood to many people in rural areas. Possibly, the liberalisation of trade in a particular produce grown may threaten rural areas as more competitive (mechanised) European producers take over the market and hence take away the little income that was generated by the trading of surpluses (although consumer could benefit from cheaper agricultural imports).

4.2 Balance of payments support

Another option is to address directly the budgetary consequences of tariff elimination under an EPA. One way, which largely depends on the good will of the donor community, is to set up a compensation or accompanying mechanism for the loss of fiscal revenues as a result of an EPA. Balance of payment support may prove the most effective means to assist countries experiencing a decrease of revenues from trade taxes. Such budget support would complement other grants, which already constitute a major source of finances - much larger than the expected losses of customs duties - for many ACP countries, as illustrated by Table 9.

Such an approach raises several issues. First, how would the amount of support for compensation or adjustment support be determined? As indicated in Section 3.2, expected fiscal losses from an EPA tend to be overestimated, and ignore any dynamic effects into the economy. Any compensation should thus rather be based on *ex post* effective fiscal losses incurred, with the possibility of advanced payment if necessary. Second, larger fiscal losses may be experienced by larger and relatively more advanced developing countries. A one-for-one compensation mechanism would favour them, perhaps at the expense of less developed countries. This would be the case for instance for Nigeria and Ghana, in West Africa, that would stand to gain more from a compensation mechanism than poorer countries such as Benin or Niger (see Table 6). Donors may be reluctant to fund such a mechanism they may perceive as unfair. Third, balance of payments support can only assist governments during their adjustment process. The permanent nature of the fiscal revenue losses arising from trade liberalisation imply that ACP governments must find a permanent solution to cope with these losses. Aid support can only be a temporary kind of solution and should not constitute a disincentive for the ACP to actively engage in an adjustment process.

Still, balance of payment support can prove very valuable to some ACP governments during the time they undertake the much-needed fiscal adjustments, possibly through the introduction or strengthening of a VAT system.

Table 9: Overview of aid for some ACP countries

Country	Total aid flows, 2003 in mio. USD[a]	Grants as percentage of GDP, 2003[a]	Expected fiscal revenue loss as percentage of GDP[b]	Present value of debt (% of gross national income), 2004[c]
Ethiopia	1504	8.0%	-0.8%	30
Mozambique	1033	10.6%	-0.2%	17
Tanzania	1669	6.2%	-0.3%	22
Uganda	959	7.0%	-0.2%	33
Zambia	560	7.0%	-0.5%	36

Sources: (a) OECD & AfDB (2005); (b) fiscal loss from UNECA (2005a), GDP from World Bank (2005); (c) World Bank (2005).

4.3 Fiscal reform and an EPA

The fiscal challenges facing most ACP governments in an EPA will not be adequately addressed by maintaining the current tax system and adopting revenue-based list of products to be excluded from an EPA. The loss of customs duties from an EPA will require that revenue be raised from other sources. The need for fiscal adjustment as a result of trade liberalization in general, and the coming into effect of EPAs in particular, is obvious. The most favoured option is the introduction of a value-added tax (VAT), arguably the least distortionary tax available[24], to compensate for the lowering of tariffs.

Since VAT is levied on both domestically produced and imported goods, unlike customs duties which are levied on imports only, it is possible in principle to generate more VAT-income than the revenue lost as a result of the elimination of tariffs. This increase in revenues does not come at the cost of lower efficiency gains since domestic producers are no longer protected behind tariff walls. If the VAT is set at a rate identical to the one of the import duty, total welfare will not decrease either since consumers still face the same prices.[25] The potential higher VAT revenues could allow a government to take accompanying measures to alleviate the transition costs on those sectors or segments of the population that stand to lose most from liberalisation[26].

A major concern that many observers have is the perceived administrative challenges countries will need to overcome if they are to implement a successful VAT system. Of course, regardless of the choice of tax system a government will need to overcome these challenges but, as mentioned earlier, trade taxes do require less administrative capacity than other taxes. Yet, it is important to note that a lot of the VAT is collected at the border. Although tariffs will be eliminated, customs officials that used to collect import duties have also always collected the VAT on imports and the customs department will continue to collect VAT on the border. Many developing countries collect more than 50% of their VAT income from imports (IMF, 2005). For most ACP countries, as they have already implemented a VAT system with quite high rates (see Table 10), the main option seems to enhance their administrative capacity to collect more revenue from VAT.

Indeed, most countries do not manage to collect their VAT in an efficient manner, leading to lower than expected amount of VAT income.[27] For instance, UNECA (2005a, p.203) notes that, in

[24] The distortions create efficiency losses, which affect the economy negatively. VAT, an indirect tax, is favoured over direct taxes which distort people's or companies' decisions to work, produce or consume. VAT is considered to incur lower efficiency losses. VAT is also the most favoured of the indirect taxes because, by taxing the value added at each production stage, it is more transparent than other indirect taxes, which usually only tax at one stage. It can also be suggested that excise taxes, i.e. taxes that are levied on specific product groups (such as tobacco and gasoline for instance) may constitute an option as well. In addition, if levied on all products imported, excise taxes would substitute for removed customs duties, hence preventing any fiscal loss. However, the benefits of excise taxes may be substantially reduced by fraudulent exporters and importers who list their products differently to avoid this tax.

[25] Stability of prices is theoretically possible, by replacing a tariff on a product with a VAT of the same rate. The countries concerned currently have a single VAT rate. Since many different VAT rates make its administration more complicated, less effective and more costly, it seems unlikely that many more VAT rates will be introduced. In practice, consumers will likely face different prices.

[26] Despite these advantages, critics of the VAT have pointed out that the VAT is not a progressive tax, unlike income tax whose rates usually increase as taxed income goes up, and would therefore fail to serve redistributive ends, which may be an important policy objective in countries with large income disparities, as is often the case in developing countries. Yet, as Ebrill *et al.* (2002) have pointed out, redistribution or fairness are determined by the tax system as a whole and a single tax.

[27] In European countries, with similar VAT rates, the proceeds constitute a much larger percentage of total revenues than they do in these countries.

Zambia, VAT "non-compliance is estimated as high as 50% because of the failure by businesses to register as taxpayers [ ] and as a result of under-reporting of sales for tax purposes"[28].

Table 10: Introduction dates and rates of VAT in several ACP countries

Country	Date	Rates (%)
Ghana	December 1998	12.5
Mauritania	January 1995	14
Congo, Republic of	June 1997	8, 18
Gabon	April 1995	10, 18
Botswana	July 2002	10
Namibia	November 2000	15
Rwanda	January 2001	18
Zimbabwe	January 2004	15
Suriname	April 1999	8, 10
Vanuatu	August 1998	12.5

Source: International Tax Dialogue, 2005.

The question therefore is in what ways VAT systems need to be designed or transformed in order to minimise the administrative burden and discretionary effects and maximising revenue. The IMF made several recommendations to that end (Ebrill *et al.*, 2002). First, a single tariff is generally preferable to multiple tariffs. In this way the administrative burden is the lightest and there is no incentive for tax evasion[29]. Second, the VAT system should have as few exemptions as possible. Exemptions, excluding certain products from VAT, bring about a larger administrative burden and incentives for fraud[30]. An additional factor that determines the success of the VAT is the threshold-value of annual turnover a company must reach to qualify under the VAT system. Low thresholds bring about a large administrative burden for the tax administrations, having to collect smaller VAT proceeds at high costs[31]. The inherent distortion that arises from such a threshold, since the economy is divided in a VAT and a non-VAT economy, is offset by the revenue gains.

It is very difficult to estimate the costs of the tax administration reform programmes that will need to be carried out by ACP governments in order to strengthen their tax revenue collection systems. A Commonwealth study (Milner, 2006) attempts to provide an insight into the costs of the these programmes by looking at the costs of past fiscal reform programmes and using this information to estimate what the costs of equivalent programmes would be in all countries. To do this, countries are categorized by size and current level of trade restrictiveness, assuming that the larger the country and the more restrictive the trade regime (higher average tariffs) are, the higher the costs are. Rough estimates of the costs of such programmes for selected ACP countries are reported in Table 11.

[28] Several factors may explain this situation. For instance, reviewing the VAT collection efficiency differences across countries, Ebrill *et al.* (2002) find that a high ratio of trade to GDP, high literacy rates and the age of the VAT are all positively correlated to a better collection efficiency of VAT.

[29] However, when the VAT is considered as replacing trade taxes, a uniform VAT leads to more distortions in prices and, as Emini *et al.* (2005) have suggested, adverse poverty impacts.

[30] Still, for reasons of poverty alleviation many countries exclude basic life necessities (staple foods, basic clothing, etc.) from VAT to keep prices down.

[31] In Uganda and Ghana, VAT systems initially failed (Ghana) or almost failed (Uganda) because the threshold was too low. Since Ghana increased the threshold from an annual turnover of USD 20000 to USD 75000 and Uganda from USD 20000 to USD 50000, the VAT system has functioned much better.

More worrisome is the conclusion by Baunsgaard and Keen (2005) that, looking at past experience that low-income countries, irrespective of whether they had a VAT or not, did not manage to replace the revenue lost from trade taxes by taxing other sources.[32] They concluded that low-income countries with a VAT system recovered 40% of the revenue lost as a result of trade liberalisation, which shows that although VAT improves the recovery rate, it is still not nearly enough[33]. To be sure, fiscal reform is a difficult challenge that most developing countries will have to face. The conclusion of EPAs will provide an additional incentive, as well as an additional burden, to transform the tax system. To facilitate this reform process, accompanying measures will be required. These may take the form of technical assistance and temporary budget support, among others.

Table 11: Estimates of Tax Administration Reform programme costs in several ACP countries

	Costs (mil. Euro)
Total ACP	2975
ECOWAS-EU EPA	955
Nigeria	155
Benin	70
Mali	70
SADC-EU EPA	340
Swaziland	60
Angola	40
ESA-EU EPA	825
Ethiopia	70
Sudan	90
Comoros	30
CEMAC-EU EPA	270
Equatorial Guinea	15
Chad	50
Pacific-EU EPA	210
Palau	20
Papua New Guinea	50
CARIFORUM-EU EPA	375
Trinidad and Tobago	40
Haiti	50

Source: Milner (2006)

[32] It seems likely that the relation between income and revenue recovery is not direct but rather due to other characteristics, such as level of governance, which are in turn positively related to level of income.

[33] Baunsgaard and Keen put their findings in perspective by arguing that behind the 40% result of the econometric generalisations are many diverse country experiences. Without testing their hypothesis, the authors suggest that countries which adhere to the 'orthodox desiderata of single base, minimal exceptions and a reasonable threshold' have better recovery capacities than countries which do not follow these guidelines. As examples they mention Uganda, which managed to more than offset revenue losses by using the 'orthodox' VAT and Egypt, which has a very unorthodox VAT system and experienced falling revenues even in excess of the trade tax revenue losses.

5 Conclusion

The conclusion of EPAs is primarily aimed at fostering the development of ACP countries. However, by aiming at opening up ACP markets to Europe, which often constitutes the main trading partner of (African) ACP economies, the envisaged free trade areas will have a significant impact on fiscal revenues for many ACP countries. Considering that many of these countries are already poor (LDCs) highly-indebted countries, a loss of public revenues of some percentage points may have very negative consequences on their development and on poverty alleviation.

The precise effects of the elimination of tariffs under an EPA remains difficult to estimate, as it depends on many factors, relating both to the scenario of liberalisation and the methodology adopted in the impact assessments. In general, impact studies tend to overestimate the negative effect of EPAs on fiscal revenues. Nonetheless, it is clear that the vast majority of ACP countries will experience budgetary difficulties as a result of the loss of trade tax revenue under an EPA.

To address this challenge, several strategies, perhaps complementary, can be envisaged. The first is to exclude from liberalisation the products that have the highest tariffs and generate the most trade tax revenues, in order to minimise the loss of customs revenues. Such an exclusion list can cover products up to the proportion authorised under WTO rules (i.e. Article XXIV of GATT 1994), which could comprise around 80% of ACP imports from the EU according to the European Commission. Rough estimates suggest that such a strategy could mitigate half or more of the fiscal impact of an EPA, provided that countries could have their way. However, since EPA negotiations take place at the regional level, it is likely that all the national exclusion lists will not overlap and thus will not be easily consolidated into a regional list. Imports that generate significant customs revenue in some countries will thus have to be liberalised against the wish of these countries, creating regional tensions and larger than expected fiscal revenue losses.

A second strategy is thus to seek additional balance of payment support to compensate for or facilitate the fiscal adjustment to the loss of trade tax revenue under an EPA. While a one-for-one euro compensation is unlikely to gain the support of any donor, such budget support could provide a useful tool to assist in a temporary way some countries that may be adversely affected by a sudden loss of fiscal revenue due to an EPA. However, balance-of-payment support cannot be sustained over time and therefore would require complementary measures.

The most sustainable strategy over time for ACP countries is to engage in effective reforms of their fiscal regime. A first useful step to compensate the fiscal revenue loss of an EPA might be the introduction of a value added tax. In countries where such a VAT system is already in place, measures should be taken to increase the rate, the base or the collection efficiency of the VAT and other tax systems. In general, the administrative burden can be minimised by keeping the VAT mechanism as simple and straightforward as possible.

In any event, there is no miracle solution! Fiscal adjustments and reforms need time and dedicated effort. ACP countries also need to show determination and gather support, as the determination and implementation of fiscal policies are prone to pressures from economic and political vested interests that seek to influence any reform attempt. It is urgent that before the conclusion and implementation of any EPA, the ACP, with the support of their European partners, actively engage in identifying appropriate accompanying measures that could be taken in each ACP region and country to address the potentially significant impact on fiscal revenue that an EPA is expected to generate. To this end, the approach adopted for the design of an EPA and complementary policies and measures must be tailored to the specific conditions of each country and/or region. This paper is only a first attempt to usefully contribute to identifying some of the broad parameters to do so in particular in IA partner countries and beyond, in the rest of the ACP countries.

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ANNEX 1 Lists of sensitive products to minimize fiscal loss

In section 4.1 the strategy (developed by Stevens and Kennan) that might enable countries to minimise their customs revenue losses is discussed. This strategy offers an insight how much customs revenue ACP countries engaged in EPA negotiations can retain after the EPA has taken effect by excluding the most sensitive (read: most profitable) products from the negotiations. It is assumed that the countries can exclude a maximum of 20% of their imports from the EPAs to maintain WTO compatibility ('substantially all trade' must be liberalised according to GATT XXIV), a *sine qua non* for the EPA negotiations outcome (at least as far as the EU is concerned). The informal suggestion by the EC DG Trade, as presented in Table 9, allowing for more exclusion for Tanzania, Mozambique and Lesotho is not taken into consideration here.

In this annex the outcome of such a strategy is presented some ACP countries. The authors have manipulated the dataset compiled by IDS; this dataset is available to ACP governments upon request. The lists of products to be excluded is isolated by sorting the list of all products imported from the EU first by tariff line (which is also its profitability) and then by value of imports; both in descending order. Starting with the product that faces the highest tariff line and whose value of imports is higher than any other product facing the same tariff line, more products are selected until the total value of imports selected reaches 20% of total imports. The products now selected constitute all the goods a country would exclude from liberalisation if it would pursue the strategy to minimise fiscal revenue loss. It must be stressed that this list, by design, is biased towards products with high tariff lines and not towards products that generate a lot of revenue. A product that faces a low tariff but is imported a lot is not selected while a product that is imported very little but faces a high tariff line will more likely be selected. It must be noted that the list of products to be excluded is only as accurate as the import data provided. Imports which are not registered and products that are imported irregularly and not in the period covered by the dataset are excluded from the data and hence from the list of products to be excluded.

Only to provide an insight into which relevant products are included in these country-specific lists, the tables below show the ten products to be excluded which have the highest shares in total revenue (i.e. the products have the highest value of imports). From the tables it can be concluded that for these countries, these ten products constitute about half the value of imports to be excluded from the EPAs. However, the complete lists are much longer. For example, Tanzania would have to exclude more than 800 products from liberalisation if it would adopt this strategy. The description of the product categories only serves an indicative purpose, the exact definition of each HS6 code can be found at: www.wcoomd.org/ie/En/Topics_Issues/HarmonizedSystem/DocumentDB/TABLE%20OF%20CONTENTS.html

Furthermore, the tables below show how much value would be retained, as a percentage of current total EU import duties, if the country would be able to exclude all the products in the list. Also, the highest tariff which will be liberalised under an EPA is reported. This marginal tariff also serves as a rough estimate of trade restrictiveness; the higher the marginal tariff, the more trade restrictive a country probably is.

Arguably, one of the most important conclusions that could be drawn from the data reported is the difficulty EPA regions would face if they would try to carry out this strategy. Even when only the top ten most valuable imports, as reported in the table, are compared with other countries, one could clearly see that the overlap, with only a few countries of each EPA region, is minimal. This overlap only becomes smaller if the total number of products on each country-specific list is taken into account. Also, by excluding the products with the highest tariffs countries also exclude products whose liberalisation could bring about the largest increases in welfare.

Table A.1 Ethiopia

Total tariff revenues	**57.4**	**million euros**
Percentage of revenues covered by 20% most profitable imports	**50.4**	**percent**
Marginal tariff, the highest tariff that will be liberalised under an EPA	**30**	**percent**

Ten imports generating most revenue

HS6 code	simplistic description	share of product in total revenue	cumulative share of total imports
870210	motor vehicles for the transport of 10 people or more	7.7%	2.7%
190190	malt extract; food preparations of flour, groats, meal, etc.	3.1%	3.7%
240220	cigarettes, containing tobacco	2.9%	5.0%
870600	chassis fitted with engines	2.7%	6.0%
210690	food preparations, not elsewhere specified	2.6%	7.2%
870323	motor cars designed for the transport of people	1.7%	7.7%
903300	parts & accessories for machines, appliances, instruments	1.7%	8.5%
220830	Whiskies	1.6%	9.2%
870324	large motor cars designed for the transport of people	1.6%	9.8%
903180	instruments and appliances for measuring or checking	1.5%	10.5%

(a) 20.3% of total imports is levied a tariff of 30%; for all other imports the maximum tariff is 20%

Table A.2 Kenya

Total tariff revenues	**111.9**	**million euros**
Percentage of revenues covered by 20% most profitable imports	**42.4**	**percent**
Marginal tariff, the highest tariff that will be liberalised under an EPA	**35**	**percent**

Ten imports generating most revenue

HS6 code	simplistic description	share of product in total revenue	cumulative share of total imports
630900	worn clothing and clothing accessories	9.1%	3.9%
870422	motor vehicles for the transport of goods, weight 5-20 tons	3.1%	5.3%
870323	motor cars designed for the transport of people	2.7%	6.4%
480257	uncoated paper, used for graphic purposes, in sheets	1.0%	6.9%
870324	large motor cars designed for the transport of people	1.0%	7.3%
480255	uncoated paper, used for graphic purposes, in rolls	0.8%	7.6%
330300	perfumes and toilet waters	0.8%	7.9%
220830	whiskies	0.6%	8.3%
210690	food preparations, not elsewhere specified (n.e.s.)	0.7%	8.6%
190219	uncooked pasta, not stuffed or prepared, w.o. eggs	0.7%	8.9%

Table A.3 Mozambique

Total tariff revenues	**18.3**	**million euros**
Percentage of revenues covered by 20% most profitable imports	**53.4**	**percent**
Marginal tariff, the highest tariff that will be liberalised under an EPA	**25**	**percent** (a)

Ten imports generating most revenue

HS6 code	simplistic description	share of product in total revenue	cumulative share of total imports
852990	parts suitable for transmission apparatus for audio & video	5.9%	2.2%
852520	transmission apparatus for audio & video	5.3%	4.2%
220830	Whiskies	3.5%	5.5%
630900	worn clothing and clothing accessories	3.3%	6.8%
220421	wine of fresh grapes, incl. fortified wines	1.4%	7.3%
870323	motor cars designed for the transport of people	1.4%	7.8%
071310	dried, shelled peas pisum sativum	1.1%	8.3%
870333	large motor cars designed for the transport of people	1.1%	8.7%
940310	metal furniture for offices (excl. seats)	1.0%	9.1%
392690	articles of plastics or other materials of heading 3901 to 3914	0.9%	9.4%

(a) 21.3% of total imports is levied a tariff of 25%; for all other imports the maximum tariff is 7.5%

Table A.4 Tanzania

Total tariff revenues	**38.3**	**million euros**
Percentage of revenues covered by 20% most profitable imports	**47.6**	**percent**
Marginal tariff, the highest tariff that will be liberalised under an EPA	**15**	**percent**

Ten imports generating most revenue

HS6 code	simplistic description	share of product in total revenue	cumulative share of total imports
630900	worn clothing and clothing accessories	6.1%	2.4%
732690	articles of iron or steel (ex. cast articles or iron or steel wire)	4.2%	4.0%
210690	food preparations, not elsewhere specified	2.2%	4.9%
852990	parts suitable for transmission apparatus for audio & video	2.2%	6.3%
200290	tomatoes, prepared (excl. whole or in pieces)	1.3%	6.8%
040221	Milk and cream in solid forms	1.2%	7.3%
841821	household refrigerators, compression-type	1.1%	7.7%
690890	glazed ceramic flags and paving, hearth or wall tiles	1.1%	8.2%
220300	beer made from malt	1.1%	8.6%
190190	malt extract; food preparations of flour, groats, meal, etc.	0.8%	8.9%

Table A.5 Uganda

Total tariff revenues	**7.0**	**million euros**
Percentage of revenues covered by 20% most profitable imports	**74.9**	**percent**
Marginal tariff, the highest tariff that will be liberalised under an EPA	**7**	**percent**

Ten imports generating most revenue

HS6 code	simplistic description	share of product in total revenue	cumulative share of total imports
630900	worn clothing and clothing accessories	7.8%	1.9%
852990	parts suitable for transmission apparatus for audio & video	6.7%	3.5%
847290	office machines, not elsewhere specified	3.9%	5.4%
870899	parts for motor vehicles for transport of ten or more people	3.3%	6.2%
210690	food preparations, not elsewhere specified	2.9%	7.7%
690890	glazed ceramic flags and paving, hearth or wall tiles	2.7%	8.4%
330590	preparations for use on the hair (excl. shampoos and other)	1.9%	8.8%
870323	motor cars designed for the transport of people	1.6%	9.2%
040221	Milk and cream in solid forms	1.5%	9.5%
870324	large motor cars designed for the transport of people	1.4%	9.9%

Table A.6 Zambia

Total tariff revenues	**10.4**	**million euros**
Percentage of revenues covered by 20% most profitable imports	**43.2**	**percent**
Marginal tariff, the highest tariff that will be liberalised under an EPA	**15**	**percent**

Ten imports generating most revenue

HS6 code	simplistic description	share of product in total revenue	cumulative share of total imports
870422	motor vehicles for the transport of goods, weight 5-20 tons	3.7%	2.4%
847330	parts of automatic data processing machines	3.0%	4.4%
854460	electric conductors, for a voltage > 1.000 v, insulated, n.e.s.	2.9%	5.5%
630900	worn clothing and clothing accessories	2.8%	6.6%
870324	large motor cars designed for the transport of people	2.5%	7.6%
870899	parts for motor vehicles for transport of ten or more people	2.4%	9.1%
870323	motor cars designed for the transport of people	1.8%	9.8%
392690	articles of plastics or other materials of heading 3901 to 3914	1.7%	10.5%
391731	plastic flexible tubes, pipes and hoses, and fittings	1.7%	11.2%
870332	motor cars designed for the transport of people	1.6%	11.8%

Table A.7 Papua new Guinea

Total tariff revenues	**2.4**	**million euros**
Percentage of revenues covered by 20% most profitable imports	**42.6[a]**	**percent**
Marginal tariff, the highest tariff that will be liberalised under an EPA	**0[a]**	**percent**

Ten imports generating most revenue[a]

HS6 code	simplistic description	share of product in total revenue	cumulative share of total imports
160249	prepared or preserved meat and offal of swine	46.3%	5.2%
730890	structures and parts of structures, of iron or steel, n.e.s.	13.3%	6.7%
160232	meat or offal of fowls of the species gallus domesticus	9.6%	7.8%
730840	equipment for scaffolding, shuttering, propping, etc.	7.2%	8.6%
480256	uncoated paper, used for graphic purposes, in small sheets	3.0%	9.1%
392690	articles of plastics or other materials of heading 3901 - 3914	2.9%	9.5%
482320	filter paper and paperboard, in strips/rolls of a width <36 cm	2.1%	9.9%
160100	sausages and similar products, of meat, offal or blood	1.6%	10.1%
392329	sacks and bags, incl. cones, of plastics	1.3%	10.2%
110100	wheat or meslin flour	0.8%	10.4%

(a) one item with HS6 code, 730810, which are bridge parts of steel and iron and face tariffs of 20%, represented more than 20% of imports and could thus not be included in the 'exclusion basket'. The rest of the goods that face a non-zero tariff only account for 12.2% of imports; therefore no tariffs will have to be eradicated according to this method (except for bridge parts).

Table A.8 Jamaica

Total tariff revenues	**26.8**	**million euros**
Percentage of revenues covered by 20% most profitable imports	**91.7**	**percent**
Marginal tariff, the highest tariff that will be liberalised under an EPA	**15**	**percent**

Ten imports generating most revenue

HS6 code	simplistic description	share of product in total revenue	cumulative share of total imports
852520	transmission apparatus for audio & video	10.4%	2.7%
870323	motor cars designed for the transport of people	10.1%	4.0%
040221	Milk and cream in solid forms	4.9%	4.5%
190190	malt extract; food preparations of flour, groats, meal, etc.	4.8%	5.7%
490199	printed books, brochures and similar printed matter	3.1%	6.8%
220820	spirits obtained by distilling grape wine or grape marc	2.9%	7.3%
070310	fresh or chilled onions and shallots	2.7%	7.7%
870899	parts for motor vehicles for transport of ten or more people	2.6%	8.2%
220710	undenatured ethyl alcohol, of alcoholic strength of >= 80%	2.5%	8.6%
040210	milk and cream in solid forms, fat content of <= 1,5%	2.2%	9.0%

ANNEX 2 Government Finances 1998-2002

(as a percentage of GDP)

	1998	1999	2000	2001	2002
ETHIOPIA					
Revenues		**14.8**	**15.5**	**16.5**	**16.4**
Tax		10.1	11.3	12.6	12.1
Import duties		4.0	4.9	5.2	5.2
Expenditures		**21.4**	**15.8**	**16.8**	**19.9**
Grants		**2.7**	**4.0**	**3.9**	**6.7**
Balance with grants		**-9.3**	**-4.5**	**-8.4**	**-8.1**
Balance without grants		**-12.0**	**-8.5**	**-12.3**	**-14.8**
MOZAMBIQUE					
Revenues	**11.3**	**12.0**	**13.2**	**13.3**	**14.2**
Tax	10.5	11.0	12.1	11.8	12.5
Import duties	2.0	2.0	2.2	2.1	2.2
Expenditures	**21.6**	**24.7**	**27.3**	**34.6**	**34.1**
Grants	**8.1**	**11.7**	**8.0**	**14.8**	**11.8**
Balance with grants	**-2.4**	**-1.5**	**-6.0**	**-6.6**	**-7.9**
Balance without grants	**-10.5**	**-13.2**	**-14.0**	**-21.4**	**-19.7**
TANZANIA					
Revenues		**11.3**	**12.0**	**11.8**	**12.1**
Tax		10.1	10.7	10.6	11.0
Import duties		1.3	1.2	1.0	1.1
Expenditures		**18.6**	**16.9**	**17.2**	**19.8**
Grants		**4.5**	**3.7**	**4.3**	**6.2**
Balance with grants		**-3.3**	**-1.6**	**-1.1**	**-1.6**
Balance without grants		**-7.8**	**-5.3**	**-5.4**	**-7.8**
UGANDA					
Revenues	**11.6**	**11.8**	**11.3**	**12.2**	**12.1**
Tax	10.8	10.3	10.3	11.2	11.3
Import duties	1.2	1.2	1.4	1.1	1.1
Expenditures	**19.3**	**26.7**	**21.8**	**24.4**	**23.4**
Grants	**10.9**	**10.4**	**10.3**	**11.2**	**11.3**
Balance with grants	**-2.7**	**-9.1**	**-2.6**	**-5.3**	**-4.3**
Balance without grants	**-7.7**	**-14.8**	**-10.5**	**-12.2**	**-11.3**

	1998	1999	2000	2001	2002
ZAMBIA					
Revenues	**18.8**	**17.7**	**19.4**	**19.2**	**17.9**
Tax	18.1	17.2	19.2	18.7	17.5
Import duties	4.7	2.4	3.4	4.1	5.1
Expenditures	**30.6**	**29.4**	**31.0**	**32.2**	**31.3**
Grants	**6.6**	**8.0**	**5.7**	**5.8**	**8.3**
Balance with grants	**-8.0**	**-4.0**	**-7.0**	**-8.1**	**-6.3**
Balance without grants	**-14.6**	**-12.0**	**-12.7**	**-13.9**	**-14.6**

Source: IMF Article IV Consultations and Statistical appendices

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