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European Development Cooperation to 2010

EU trade partnerships with developing countries

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This series of Briefing Papers will identify the main issues in the debate about European Development Cooperation to 2010.

The EDC 2010 project has identified two main drivers of change with respect to European development cooperation. The first is the degree of commitment to Europe, the second the commitment to poverty reduction. The interaction of these two gives four possible European futures: at one extreme, a strong commitment both to coherent European action and to poverty reduction; at the other, a weak commitment to both Europe and poverty reduction; and, in between, two intermediate positions.

EDC 2010 is a project of the European Association of Development Research and Training Institutes (www.eadi.org/edc2010).



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The picture in brief

The EU's trade relations with developing countries have changed considerably in the last decade; the preference system has become increasingly complex. Since 2000, the relation between trade and development has been one of six declared priority areas for EC development cooperation. The strengthening of multilateral rules in the context of the WTO has important implications for the conduct of EU trade policy. Revisions and reviews of trade initiatives such as the Generalised System of Preferences (GSP), including the 'Everything but Arms' (EBA) amendment, and trade-related aspects of the Cotonou Partnership Agreement will determine the agenda, but WTO regulations now set the environment for bilateral trade agreements and, as such, shape negotiations. The Doha Development Round will influence the future balance of multilateral, regional, and bilateral approaches in EU trade partnerships. The lack of coherence between the different approaches in trade policy and between trade and other policies of the EU remains an overall feature.

Issues and options

- How to reconcile the special status of the ACP Group with the EU's obligations to the WTO? After almost three decades of offering the ACP non-reciprocal preferential access, the EU plans to replace the existing trade regime by Economic Partnership Agreements (EPAs). These would not be fully reciprocal: the ACP argue that poor and small developing countries need asymmetric treatment, which the WTO allows only on a non-discriminatory basis for all developing countries (GSP, for example).
- How to reconcile special treatment for the Least Developed countries (LDCs) with EPAs based on regions of ACP countries? Under the EBA initiative, LDCs have been granted duty-free and quota-free access to the EU for all products. The regions, however, all include both LDCs and others, so either the EPAs must provide for differentiation among members or they will offer worse treatment to the LDCs than they have under EBA.
- How to reconcile the EU's programme of extension of its regional arrangements to an increasing number of developing countries (to the ACP and others) with its support for multilateralism? Multilateral negotiations are needed to deal with the difficult issues on the WTO agenda, such as agricultural reform. Regionalism could undermine the multilateral process both through creating countries with an interest in protecting regional or preferential access and through the strain it places on negotiating resources (especially in LDCs).
- How to reconcile differentiated trading arrangements with development goals? Each additional offer of special treatment to some developing countries, whether through regions or preferences, creates losers in other developing countries.
- How to make the EU's trade policy coherent with its development goals? Member States and small groups within them have protected domestic production and prevented reforms, for example of the Common Agricultural Policy (CAP), which would offer opportunities to developing countries.

EU trade relations with developing countries

The Commission's role

External trade in goods is a competence of the European Community (EC). The European Commission has the legal authority to negotiate trade agreements with third countries on behalf of the Member states (Articles 133 and 300 EC Treaty). The progressive extension of the international trade agenda has repeatedly forced the EU to redefine the institutional balance between the Commission and Member States. The task has been to weigh the need to 'speak with a single voice' in multilateral trade negotiations against the accountability of the Commission to the Council. Article 133 refers to tariffs, anti-dumping, and subsidies as areas of exclusive EC competence. Additionally, a ruling of the European Court of Justice in 1994 in the aftermath of the Uruguay Round gave Member States 'shared competence' with the EC for 'new trade issues', such as services and intellectual property rights. Member States' participation during the process of trade negotiations is ensured through an extensive consultation process with the Commission in the form of the so-called 'Article 133 Committee'.

Trade flows

In 2001, developing countries supplied 10% of total¹ EU-25 imports and took 9% of total exports. By contrast, developing countries relied more heavily on the EU as both a consumer and supplier. In the same year, the EU-25 accounted for one-sixth of total developing country exports and imports, although this was sharply down from 1990 (see figure 1). Considerable shifts in EU market share among developing countries have taken place within the developing world. ACP exports to the EU-25 have stagnated at around \$27 billion (about 40% of their total exports) for almost thirty years, so their share in total EU-25 imports has been declining. In contrast, imports from Asia have been growing. In 2001, China was the third-largest exporter to the EU-25 with a share of 3% in total imports after the United States (8%) and Japan (3%).

EU trade preferences

In the past, EU trade policy was described as a 'pyramid of preferences' with those countries at the top receiving the most preferential market access, while only a minority of (industrialised) countries benefit from most-favoured-nation (MFN) treatment. This simplified notion has become increasingly obscured as European trade policy has evolved into a complex web of agreements (see figure 2).

Trade agreements

The EU has signed a number of reciprocal agreements which confer greater-than-MFN market access. The European Economic Area (EEA) is an outstanding example since liberalisation has been fully reciprocal and goes

beyond the stage of 'shallow integration' (i.e. removal of border measures) into areas of 'deep integration' (i.e. mutual recognition or harmonisation of economic and regulatory policies). The Euro-Mediterranean Association Agreements as well as the free trade agreements with South Africa and Mexico provide for asymmetric reciprocity; but integration remains relatively 'shallow' in these cases.

The first bilateral trade agreements signed by the EU were Cooperation Agreements with a number of Southern Mediterranean countries (Algeria, Egypt, Lebanon, Syria) in the mid-1970s. Together with Association Agreements, concluded during the 1990s, with Israel, Morocco, and Tunisia, these led to the Euro-Mediterranean Free Trade Agreement signed in 2002. In addition, free trade agreements (FTAs) have been signed with Mexico, South Africa, and Chile. There are ongoing negotiations with MERCOSUR in South America (scheduled to be concluded by October 2004) and ASEAN in South East Asia as well as longstanding talks with the Gulf Cooperation Council. These agreements provide access on a (often non-symmetrical) reciprocal basis.

The Generalised System of Preferences (GSP)

The EU established its GSP in July 1971, under which developing countries receive unilateral, non-reciprocal tariff preferences. Gradually, the EU has expanded the range of beneficiaries, introduced increasing elements of graduation for the higher income developing countries, and offered greater benefits for the least-developed beneficiaries in the scheme.

The present version of the GSP began in 1995 and will expire at the end of 2004. The current GSP has abandoned the use of quotas and tariff ceilings which used to restrict imports on preferential terms of sensitive products. Instead, the combinations to be excluded are chosen (ostensibly) objectively, by a complex formula designed by the Commission to assess a beneficiary's level of industrial development and sectoral specialisation. In addition to this, any beneficiary taking over 25% of the share of GSP imports for a given product loses preferences for that product. As a result, certain products from large countries (e.g. Brazil, China, India, and Indonesia) have been excluded.

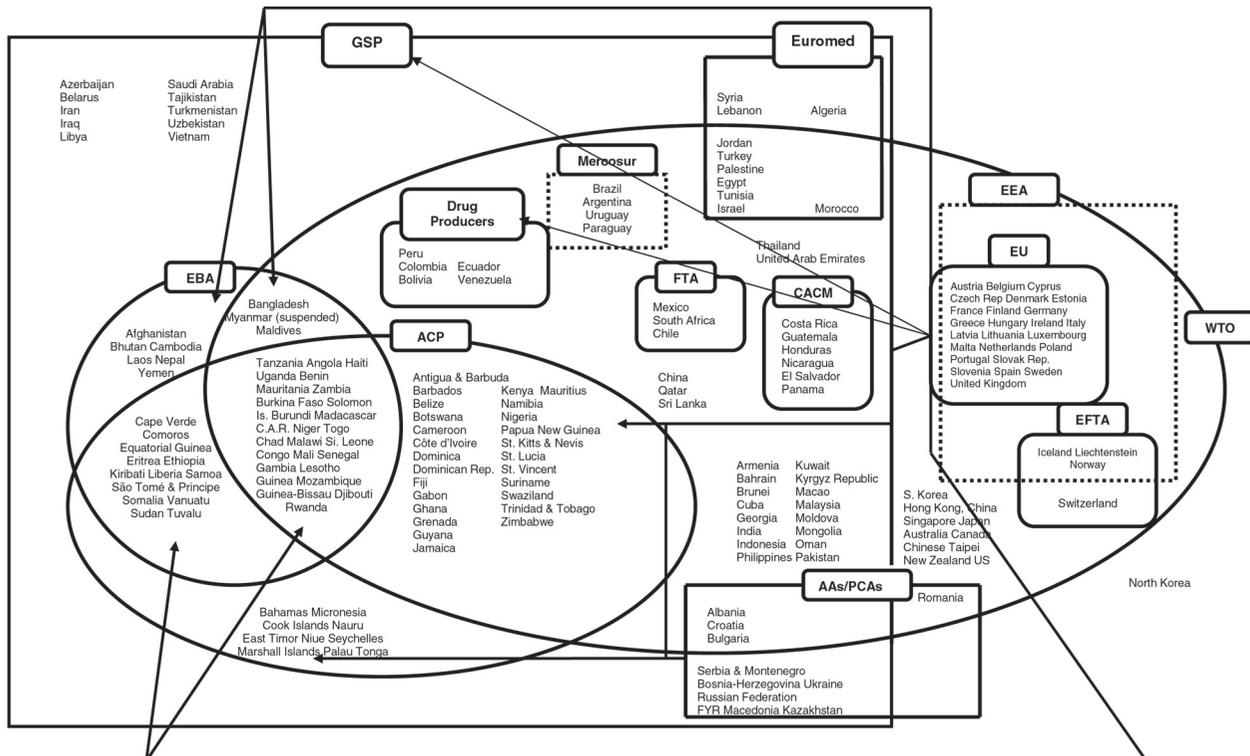
The Least Developed Countries

With its Everything But Arms regulation in 2001, the European Union extended duty and quota free access to all products originating in LDCs, except arms and ammunition. This now includes (where the ordinary GSP does not) all agricultural products, including 'sensitive' products. Only three most sensitive agricultural products were not liberalised immediately for LDCs: bananas, rice and sugar. For bananas, EBA provides for staged liberalisation between 1 January 2002 and 1 January 2006 by reducing the full (out-of-quota) tariff by 20% every year. For rice and sugar, full liberalisation will be phased in from 1 September

Figure 1: EU-Developing Country Trade Flows

Share of:	1980	1985	1990	1995	2001
EU-25 imports from developing countries in total EU imports	12%	11%	9%	9%	10%
EU-25 exports to developing countries in total EU exports	11%	10%	8%	10%	9%
Developing country imports from EU-25 in total DC imports	22%	21%	20%	19%	16%
Developing country exports to EU-25 in total DC exports	24%	23%	22%	18%	17%

Figure 2: EU Trade Regime, May 2004



Note: Arrows indicate non-reciprocal tariff preferences. Thicker lines indicate more generous preferences

2006 – 1 September 2009 and 1 July 2006 – 1 July 2009, respectively.

The ACP Group

Traditionally, the group of ACP countries, now 77 (excluding South Africa), were positioned above GSP beneficiaries in the EU pyramid of preferences. Imports from the ACP received more generous tariff preferences on a broader range of products and were subject to less restrictive rules of origin. The successive Lomé agreements (1975–2000) provided duty-free access for all industrial products (that met rules of origin) as well as for most tropical and mineral products. In addition, some agricultural products received tariff preferences (restricted by quota) and some ACP countries benefited from Special Trade Protocols (for bananas, sugar, beef/veal, and rum) which provided (limited) access to the highly protected European market. Lomé rules of origin allowed cumulation among all ACP beneficiary countries, whereas GSP only allows cumulation within designated groups of countries. Lomé also liberalised its rules of origin over time to allow cumulation to include certain non-ACP developing countries, with exceptions for certain products, and increases in permissible import-content.

Issues

Changes for the ACP group

The Cotonou Agreement (2000) replaced the Lomé Convention and marked a shift from non-reciprocal tariff preferences to establishing reciprocal trade arrangements

for all ACP countries. During a preparatory period (2000–2008), the Cotonou Agreement maintains Lomé IV non-reciprocal preferences while the EU and ACP countries negotiate Economic Partnership Agreements (EPAs) that will establish timelines for progressively liberalising trade barriers. The new trading arrangements will enter into force by 1 January 2008, after which liberalisation will be phased in over a period of at least 12 years; the EU expects these agreements to be with regional groupings.

The EU intends that EPAs should comply with WTO rules (Article XXIV regarding preferential trade agreements; i.e. liberalising substantially all trade within a reasonable period of time (10–12 years). In addition to trade in manufactures and agricultural products, EPAs could also cover trade in services as well as other trade-related areas such as non-tariff and technical barriers to trade. The latter could include issues such as investment, competition, protection of intellectual property rights, standardisation and certification, and sanitary and phytosanitary measures.

The EU and ACP countries provide the establishment of EPAs with a number of challenges. First, under EBA all LDCs have full duty-free and quota-free access to the EU market, except for arms (and, until 2009, for bananas, rice and sugar). This removes the incentive (of access to the EU market) for least developed ACP countries to open their markets for EU products, within the context of an EPA.

Second, providing differential treatment to ACP states at different levels of development within defined regional arrangements remains problematic. Haiti (least developed), for example, will be participating alongside

Barbados in CARICOM negotiations for an EPA. Third, some regions will be divided by EPAs. Egypt, although a member of COMESA, will not be involved in negotiations for an EPA since it is not an ACP country and has a separate agreement with the EU.

Finally, memberships of existing regional organisations overlap, particularly in Southern and Eastern Africa: the South African Development Community (SADC), the Common Market of East and Southern Africa (COMESA), and the East African Community (EAC) all share members.

Market access

In 2000, imports entering the EU under MFN rates faced a simple average tariff of 5%; the 'normal' GSP average preferential tariff was 3%; and EU imports under the ACP programme and Everything But Arms (EBA) were subject to an average tariff of about 0.1%. Although these preferential tariffs appear to be very low, the average rates include some high tariffs in individual product lines, particularly on 'sensitive' goods. Almost half of all agricultural products are excluded from coverage under the GSP; the Common Agricultural Policy with its goal of high EU producer incomes inhibits market access for competitive suppliers, including those from developing countries. Although the Lomé and Cotonou arrangements reduced the number of exclusions, EBA is more significant because it eliminates them by 2009.

In 2000, 34% (\$248bn) of extra-EU imports came from beneficiaries of the EU's GSP and ACP regimes. However, preferential treatment was granted to a considerably smaller percentage of imports from all beneficiary countries (6%, i.e. \$45bn).

The use/value of tariff preferences has been low due to the restrictiveness of rules of origin employed in the various schemes, officially to prevent trade deflection from non-beneficiary countries. Rules of origin under the various EU preferential regimes differ but are based on product-specific process criteria. The process criteria may require that imported inputs undergo a change in tariff heading;² undergo specific working or processing in the beneficiary; not exceed a specified maximum percentage of the value of the final product; or, comply with a combination of the above. The type of processing required for some products can exceed production capacity in developing countries or require producers to add an exceptionally high value in order to comply with rules of origin – particularly for certain fish, processed food and textile products. In addition, the complexity and diversity of the rules complicate documenting compliance with EU rules of origin.

Multilateralism versus Regionalism

Trade liberalisation at the multilateral level has a more favourable effect for most developing countries than partial concessions negotiated in bilateral agreements with individual countries or regions. However, the failure of the WTO meeting in Cancún might focus the EU's

Glossary

EBA – Everything But Arms (amending the GSP, regulation 2820/98, applicable from 5 March 2001). Under EBA, all LDC goods have full duty-free and quota-free access to the EU market, except for arms (and, until 2009, for bananas, rice and sugar). Services are not covered.

EPAs – Economic Partnership Agreements. Prescribed by the Cotonou Agreement as a replacement for the ACP specific trade regime; to be concluded by 2007. The EU expects these to be agreements with regional groupings, but has not ruled out individual (large) countries. EPAs could include trade in services.

GSP – Generalised System of Preferences. Preferential tariff treatment on imports of goods originating in developing countries. GSP is permitted by the WTO, but developed countries may make their own rules on product coverage and degree of preference.

MFN – Most-Favoured-Nation treatment. Under GATT/WTO rules, countries normally cannot discriminate among trading partners. In principle, the most favourable agreement with one partner sets the standard for all other WTO members; the GSP and FTAs are permitted derogations.

Rules of origin – Rules of origin stipulate conditions under which goods for export are deemed to originate from a particular country.

attention towards bilateral and regional agreements. The EU was already negotiating free trade agreements with MERCOSUR and ASEAN and had begun to negotiate EPAs with the ACP group. Even though multilateral and bilateral/regional negotiations can be managed simultaneously, expansion of the latter can strain limited negotiating resources, especially in LDCs. More importantly, a system of discriminatory liberalisation is not necessarily efficiency-enhancing, even for members (due to trade diversion), and is clearly bad for non-members (who are excluded from any benefits associated with trade creation and may suffer as a consequence of trade diversion). In addition, regionalism may actively serve to undermine the multilateral process, since regional agreements establish margins of preference for members over non-members. As such, for members of a preferential trade agreement, multilateral liberalisation can have costs associated with erosion of preferences.

Notes

¹ Intra plus extra-EU trade.

² A tariff heading is an internationally agreed code number for identifying a particular commodity.

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