

Policy Management Brief

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Challenges to ACP Trade with Europe after the Uruguay Round

The global trading environment is in a period of rapid change from which all countries are expected to benefit. The trend towards increased trade liberalisation and more competition is expected to continue in the medium and longer terms with the soon to be created World Trade Organization as a strong advocate for free trade. And unlike the GATT that it replaces, many developing countries are among its founder-members.

However, the states of Africa, the Caribbean and the Pacific (ACP) are concerned that the new situation will pose more threats than it will provide opportunities. This group is especially concerned about the impact of the new liberal environment on their trade with the European Union (EU). Under four successive Lomé Conventions, ACP exports have had preferential access to European markets -- and this is now under threat.

The concern is not new. In recent years, ACP preferences have been eroded as Most Favoured Nation tariffs and non-tariff barriers for other trading partners of the EU have been reduced. Preferences have also been extended to other developing countries. As a result, preferential margins for ACP exporters have been reduced and competition in the EU market is increasing. ACP exporters are likely to be further weakened once the full effects of the Uruguay Round agreements are felt.

It is imperative therefore that ACP states use the current mid-term review of the Lomé Convention to negotiate additional support from the EU to bolster their weakened positions. There is already agreement that aspects of the Convention adversely affected by the Uruguay Round can be discussed in the review and the Commission seems prepared to negotiate appropriate action in support of ACP exporters. The challenge for the ACP negotiators is to identify practical actions and proposals for this discussion.

This brief sets out the background for the current (generally disappointing) trade performance of ACP countries. The likely impact of the Uruguay Round on ACP preferences and exports is considered and

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Lomé Trade Provisions and ACP Trade Performance

The current fourth Lomé Convention (its origin can be traced back to the 1957 Treaty of Rome) provides preferential access to the European market for its African, Caribbean, and Pacific signatories (currently 70). Through its aid and trade provisions, the Convention commits the European Union (EU) and ACP states to promoting and diversifying ACP exports to the EU market and to decreasing ACP dependency on primary exports (article 70).

The trade provisions include non-reciprocal preferences that ACP states enjoy in the European market. This means that ACP States are granted preferential access to the EU market, and in return, they must not

Lomé Trade Provisions

The Lomé Convention is a contractual agreement between the European Union and seventy African, Caribbean and Pacific States. It contains both aid and trade provisions. The trade provisions form a significant part of the Lomé Convention and comprise:

Preferential Access:

ACP exports to the EU enjoy duty free access and are exempted from any other trade barrier on the condition that the exports meet the rules of origin (see article 168 of the Lomé Convention)

Temperate agricultural exports from ACP States that fall under the Common Agricultural Policy receive special treatment (see in Annex XL of Lomé IV)

Special protocols on the export of bananas, rum, beef and veal, and sugar, where the EU market has common policies that protect against imports (see

discriminate in their own markets between EU states. While Lomé preferences are said to give duty free access to almost 97% of ACP export products in the European market, most ACP states are aiming to increase their exports of new products and to break into protected agricultural trade markets where barriers may still be considerable.

Despite these preferences and other provisions, the overall trade performance of the ACP has been disappointing. Their share in the European market has declined and their exports to other markets have not grown significantly. ACP export structures are relatively unchanged -- diversification away from primary commodities into non-traditional and processed products has been less than hoped for. Finally, while only a few countries supply the bulk of EU imports from ACP states, the EU market is increasingly opening up to other developing countries that compete with the ACP.

Trends in the value of EU-ACP trade show that ACP countries have not succeeded in increasing their share of the EU market. Instead, from a 6.6% market share in 1976, it fell to 3.7% in 1992. Since 1985, the value of ACP exports to the EU has also declined (see table).

This might not pose a problem if exports to other countries had risen significantly. However, they have not done so, and ACP countries remain largely dependent on Europe's markets for their export earnings. Twenty-seven mainly African countries depend on their EU exports for more than 75% of their total export revenue from OECD countries. This shows that ACP states have been unable to diversify, in any significant way, their exports to markets outside the EU.

Most ACP states have not been able to make substantial changes to their trade structures in the last nineteen years. Their exports continue to be concentrated on a few primary

commodities. From 1988 to 1992, ten traditional commodities (including petroleum, coffee, cocoa, sugar, bananas, copper, aluminium and gold) accounted for almost 61% of ACP exports to Europe.

In addition to this, most ACP states have not significantly diversified their economies into non-traditional products such as clothing, leather and fish that have higher price elasticities of demand. If this had been the case, their exports would have been less vulnerable to the price shocks that hit primary commodities in the 1980's and 1990's. Furthermore, since processed or manufactured products generally have higher preferences, diversification in this direction would have increased their chances to benefit from the preferences.

The origin of European imports from the ACP is concentrated on a few countries. Between 1988 and 1992, 65% of EU imports from ACP countries originated from only ten states -- including Nigeria, Gabon, Liberia, Côte d'Ivoire, Mauritius, Ghana and Zimbabwe.

Notwithstanding their less favourable treatment, other developing countries have been more successful in the EU market than ACP states. Asian countries doubled their market share between 1976 and 1992, and the extension of EU preferences to East European and other countries is expected to increase the competition.

Why have ACP States been Unable to Take Full Advantage of Lomé Preferences?

Have ACP States been able to benefit from Lomé trade provisions? It is difficult to prove that all of them have, but the disappointing performance of ACP trade does not provide sufficient evidence to argue the opposite. Some countries (such as Mauritius, Zimbabwe, Fiji, and Jamaica) have succeeded in diversifying their economies. Others have not been so successful. On the

whole however, ACP trade performance might have been even worse without the protection and encouragement of Lomé preferences.

The preferential treatment enjoyed by the ACP group in Europe seems not to be a sufficient condition to develop ACP trade. Preferences, which were traditionally seen as a way to boost industrialisation and stimulate investment in non-traditional sectors, may have had a catalytic role in developing dynamic export sectors in some countries. Experience in other countries, however, suggests that there are other critical factors that, when they are either not present or are imperfectly aligned, restrict the accelerator role of preferences and limit the benefits that can be had from them.

Seven major factors that have limited the role of preferences can be identified: Awareness of the provisions, their complexity, human resources, national export structures, capacity to diversify exports, rules of origin, and capacities to attract investment.

- *Awareness of Lomé trade provisions.* In many ACP countries, awareness of

Performance of ACP Exports to the EU 1976-1992						
		1976 .00	1980 .00	1985 .00	1990 .00	1992 .00
Africa	billion ecu	9,4	17,0	24,2	20,1	16,0
	market share %	6,0	6,3	6,0	4,4	3,3
Caribbean	billion ecu	0,8	1,6	1,6	1,4	1,5
	market share %	0,5	0,6	0,4	0,3	0,3
Pacific	billion ecu	0,2	0,4	0,7	0,4	0,4
	market	0,1	0,1	0,2	0,1	0,1

preferential access to the European market is limited to a few officials and large exporters. This suggests that information about the provisions has been insufficiently disseminated among local exporters and entrepreneurs. It has clearly contributed to the under-utilisation of the preferences.

- *Complicated procedures.* Not only is lack of information on the provisions a problem, but the complexity of the rules and procedures that apply them also causes difficulties. As has been identified in other parts of the Lomé Convention, ACP governments, let alone small enterprises, often lack capacity to interpret and therefore conform to these requirements.
- *Export structures.* The concentration of ACP trade in primary commodities with generally lower MFN tariffs and therefore smaller preferential margins, effectively hinders countries from taking full advantage of many of the preferences they theoretically enjoy.

Estimate of ACP Losses due to Preference Erosion and the Agreement on Agriculture

The quantifiable **static loss** in export revenue resulting from the erosion of preferences on non-agricultural exports and the impact of the agreement on agriculture is estimated to be 256 million ecu, or 1.3% of ACP export earnings from the EU. According to these calculations, the ten biggest losers will be Ethiopia, Fiji, Trinidad and Tobago, Guyana, the Bahamas, Mauritius, Senegal, Jamaica, Tanzania and Malawi.

These figures do not take into account: the **dynamic implications** of preference erosion, nor that investment in new industries (often likely to enhance export diversification)

• *Export diversification.* The slow progress in export diversification in ACP states suggests that preferences for non-traditional exports are not sufficient to stimulate this crucial process. Support for production is limited, marketing know-how and awareness of European demands and standards is scarce, while intimate knowledge of evolving distribution and transport channels is in short supply.

• *Rules of origin.* The EU rules that are designed to prevent non-ACP exports being sent through ACP countries (and claiming ACP preferences) are perceived by ACP exporters as being too strict because they fail to take account of the increasing share growth of outward processing. Moreover, they do not allow ACP exporters to cumulate inputs from non-ACP or non-EU sources, although it would often be more efficient to obtain inputs automatically from cheaper or nearer sources. They therefore affect the competitiveness of ACP exports and often appear to be a disincentive for investment and diversification. Although there are derogation procedures to obtain exemptions from the rules of origin, their use is complicated and the system fails to tackle the difficulty in proving that certain exports are impeded by the rules of origin.

• *Attracting private investment.* Most ACP States have problems in creating an attractive climate that can compete with more promising markets in Asia and elsewhere. Apart from political and economic instability, government policies have not encouraged such investment with appropriate incentives. In success stories such as Mauritius, investment, both domestic and foreign, has been identified as an important factor that contributes to trade development, not only because of the financial flows, but also for the

embodied know-how in technology and marketing.

- *Human resources.* Progress in ACP economies has been slowed down by the weak human resource base. Specific technical training is often not easily available, but more important, entrepreneurial and management skills that are crucial to innovation and diversification in ACP economies, are lacking.

Effects of the Uruguay Round on ACP States

The effects of the Uruguay Round will be most keenly felt as preference erosion in the EU market, and as a result of the Agreement on Agriculture. Apart from these, the phasing out of the Multifibre Arrangement, the liberalisation of trade in services and the replacement of GATT by the World Trade Organization are also significant. These factors, together with new opportunities due to rising incomes and increased access to non-EU markets are highlighted below.

- *Preference erosion.* Existing preferences for ACP exports have been eroded by the EU's commitment to global trade liberalisation, and the globalisation of its development cooperation (in which non-ACP developing countries are more important than before). In particular, the EU offer to reduce the Most Favoured Nation tariff has eroded preferences for ACP exports. The loss in ACP export competitiveness is likely to divert trade to non-ACP suppliers and, as a result, ACP export earnings from the European market may fall. This will especially affect states that depend on a few primary export commodities, or those that have begun to export manufactured goods or processed tropical products. Preferences for some exports of primary commodities such as

Phasing out the Multifibre Arrangement

The MFA, which has restricted the exports of textiles and clothing from developing countries since 1974, will be phased out over the next ten years. In several phases the importing countries will transfer shares of their textiles and clothing exports, relating to their 1990 volumes, from the MFA to the normal GATT rules, thus eliminating bilateral quota arrangements and replacing them by tariffs.

The first phase will cover items that accounted for at least 16% of 1990 imports. This has to be complete by the end of 1994. Phase two, from 1995 to the coffee and cocoa beans, have been eliminated, while manufactured exports to the EU have been subject to an average reduction in Most Favoured Nation (MFN) tariff of almost 50%. Taken together, the preference erosion on ACP exports to the EU, other than temperate agricultural products or textiles and clothing, is expected to cause a static loss for ACP states of 144 million ecu in export earnings. This however, is only 0.7% of their total export earnings from the EU market.

- The *Agreement on Agriculture* of the Uruguay Round will lead to an increase in world market prices for agricultural exports. Within the EU however, domestic prices for temperate exports, such as beef and sugar that fall under the Common Agricultural Policy are expected to fall. The implications of these agricultural price changes vary among the ACP States, depending on whether they are net importers or exporters of food, or if they currently enjoy preferential access to the EU market under one of the protocols. Overall, the agreement on agriculture is expected to cause a net deterioration of 112 million ecu in the trade balance for

ACP States.

- ACP states have been exempt from the *Multifibre Arrangement (MFA)* that controls developing country exports of textiles and clothing to developed countries. For ACP states such as Jamaica, Mauritius, and Zimbabwe that have been able to develop these exports, the phasing out of the MFA will lead to fiercer competition once the preferences have been eroded in ten years time. However, because they have been subject to MFA type restrictions on their exports of clothing and textiles, they will benefit from the improved market access to non-EU markets that the phasing out of the MFA will bring. Phasing out the MFA

Exploiting Trade Provisions: An Example from Zimbabwe

Over the last ten years, Zimbabwe has been able to improve its trade performance in EU and other markets. From being tied to South African markets, Zimbabwe shifted its trade towards the EU, Japan, and the USA and these markets now account for 36%, 7%, and 9% of Zimbabwe's exports.

Since signing the Lomé Convention in 1980, Zimbabwe has also managed to diversify into non-traditional and processed products such as foodstuffs, tobacco, textiles, clothing, and leather products. Lomé trade preferences as well as several other factors are said to have contributed to this success. These factors include:

the level of industrialisation and skills was sufficient to guarantee both quality products and their reliable supply

managerial and technical expertise had been built up over time in both industry and government

an active trade promotion organisation - Zimtrade - was created to promote exports

will negatively affect ACP countries that are potential exporters of textiles and clothing but have not yet taken advantage of EU market preferences. In particular, investment in the textiles and clothing sector is likely to be deterred due to the loss in its competitive advantage. This is important because this sector has, in the past, proved to be crucial to the process of industrialisation

- Initially, *global liberalisation of trade in services* is expected to have a negative impact on ACP States. Currently, ACP services are concentrated in sectors, such as data processing and tourism, that have not been subject to severe restrictions so far. Gains from liberalisation will therefore be small for existing service suppliers. However, as access to local markets improves, other service suppliers from outside the country may come to dominate these ACP markets in the future.

- The *World Trade Organization (WTO)* is expected to have a positive impact, if the ACP group can strengthen its position inside the organisation. WTO decisions will be based on unweighted qualified majority voting as in GATT. This, together with transparent trade practices and rules will also benefit ACP states that lack the capacity to screen complicated procedures when negotiating. Nevertheless, in its drive for trade liberalisation, the WTO is expected to put more pressure on ACP states to open their markets and adapt their trade policies.

- Changes in the procedures for the WTO's *dispute settlement* following the Uruguay Round might also result in less favourable outcomes. The recent dispute over banana imports is a case in point. Procedures will become stricter as independent panel reports resulting from investigations of complaints against contracting parties become binding. In case of

non-compliance with a panel decision, the WTO can authorise parties affected by the offence to withdraw MFN treatment from the country.

- *Improved access to non-EU markets* is expected to benefit ACP countries. In contrast to the preference erosion in Europe, ACP states will have more access to other markets where they currently have no preferential treatment. For Pacific islands and some countries in Eastern Africa in particular, the growing Asian markets offer new opportunities. Caribbean countries will, despite the erosion of their preferences under the Caribbean Basin Initiative, benefit from a more open US economy. Concern that they will be excluded from NAFTA arrangements, should they be extended, has stimulated them to develop a proactive strategy to be included. This is the kind of action that will be needed if ACP states are to exploit the opportunities in these and other non-EU markets. Preparation is essential to deal with fierce competition, to overcome structural problems, and to increase their competitiveness.

- Rising *world income* is expected to trigger increased demand for ACP exports. Studies by

GATT, the World Bank, and the OECD predict an average annual increase of 1.05% in world income as a result of trade liberalisation. If these gains are combined with ACP export losses in the EU, the net gain of the Round to the ACP group is estimated by the Overseas Development Institute to be 0.6% of its exports. However, it has to be stressed that some countries face a net loss rather than a net gain.

International Trade Challenges for ACP States

To recapitulate the major points so far. First, ACP states have had great difficulty in exploiting trade preferences in the European market. This is not because of the preferences themselves, but largely results from other structural or capacity related factors that limit the abilities of countries to make best use of preferences available to them.

Second, existing preferences have been eroded as a result of the EU commitment to take part in global trade liberalisation and to improve access to its markets for non-ACP developing countries.

Third, increasingly critical attitudes of the international trading community (including some EU member states) towards the ACP's special relationship with the EU create additional pressures. ACP privileges will become increasingly difficult to maintain as reciprocal trading arrangements become the norm. The WTO is also likely to prohibit arrangements that adversely affect other Contracting Parties. A working party within GATT is currently dealing with compatibility

Priorities for the Short Term

1. Build awareness and capacity to deal with trade provisions by:
providing information on Lomé through information and training centres in ACP states
delivering in-country training on Lomé through information and training centres in ACP states
offering learning opportunities for ACP nationals in the European Commission and other EU offices

2. Simplify Lomé trade procedures and

Preparations for the Medium and Long Term

1. Make trade a priority by:
involving the private sector
improving the infrastructure for trade in ACP countries
adopting outward-looking trade policies
2. Attract private investment by:
creating fiscal incentives and appropriate institutional frameworks in ACP countries
encouraging the EU to stimulate European investment in ACP countries
3. Invest in human capital by:
extending opportunities for technical and management education and training in ACP states
creating twinning arrangements and exchanges of ACP experience

issues between the Lomé Convention and the GATT articles.

With these challenges in mind, it is clear that ACP and EU member states need to re-think their strategies for the development and promotion of trade between them. ACP states must better exploit existing preferences to

strengthen their competitiveness in the EU market. This is especially important in the short-term because most aspects of the Uruguay Round will only be implemented or become apparent over the next ten years. At the same time, ACP states need to focus on their comparative advantage and rely less on preferences in the EU market. This means diversifying both the structure and the destinations of their exports.

The European partners in Lomé have a vital role to play in assisting ACP states to become more competitive in world markets. It calls for concrete adjustments to existing trade provisions, judicious use of Lomé aid provisions to support trade aims, and an emphasis on capacity building in Europe and the ACP.

Options for the Short Term

In the short term, the main priority is to make good use of the preferences and provisions that already exist under Lomé. For even if preferential margins have been eroded, ACP states retain significant preferences on products such as sugar, fish, textiles, and clothing.

This Report:

Policy Management Briefs are intended for policy-makers concerned with aspects of development. Drawing from work of ECDPM, its partners, and its associates, the aim is to provide succinct and readable summaries of current issues in the management of development policy. This brief is based on work done at the Overseas Development Institute by Michael Davenport, Adrian Hewitt, and Antonique Koning.

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If ACP states are to take full advantage of both the trade preferences and the diversification opportunities in Europe, the obstacles causing the under-utilisation of the trade provisions must be removed, or their influence countered.

1. Improve capacity and awareness in the ACP

Enhanced awareness of Lomé trade provisions among government officials, the private sector and other interested parties is an essential precursor for their effective utilisation. Enhanced knowledge of Lomé aid provisions is especially important to ensure that adequate attention is paid to trade in the national and regional indicative programmes of ACP states. One option is to use information and training centres located in existing organisations in ACP states.

Regional centres would collect essential information on the Convention and take the lead in establishing regional networks of ACP expertise. They would generate training materials and organise training programmes, using local ACP expertise whenever possible. National centres would identify local needs and requirements, assist in targeting regional activities, and organise practical training. It is important that the centres be established soon if they are to be effective in the last five years of Lomé IV. Funding could be drawn from unused EDF 5 and EDF 6 funds and from national and regional indicative programmes.

The responsibility for capacity building is not one-sided. The Commission could, apart from its financial contributions, ensure that internships and other practical training and learning opportunities are available for ACP individuals to directly experience EU procedures.

2. Simplify trade procedures

The European Commission could facilitate better use of the Lomé trade provisions by

simplifying the existing procedures and requirements. This would also help to relieve capacity constraints in the ACP states.

3. Stimulate ACP trade development and product diversification.

As a necessary incentive to trade development, the ACP and the Commission must ensure the effective implementation of the Trade Development Project. This project was suggested in Annex XX of the Lomé IV Convention and has been proposed to the European Development Fund Committee. It will identify factors that inhibit the effective use of the provisions, support actions that address trade policy issues, and provide assistance in dealing with production, distribution, and marketing difficulties. It will also provide market information to ACP exporters from its Brussels focal point. It is important that this focal point is well connected to the proposed national and regional training and information centres. The centres can benefit from activities of the project, and they will be a valuable source of local expertise on Lomé.

For the two-year pilot phase of the project, twenty countries have been targeted for support to increase their exports through technical assistance, institutional development, and training. Early commitment is needed by both the EU and the ACP that this phase will be extended to the other 50 countries.

The Commission could further stimulate export diversification by relaxing its stringent rules of origin. It would be advantageous for ACP exporters if the tolerance value of non-originating material in their products was increased and simple assembly of products allowed. A re-examination of possibilities to expand the cumulation of imports from non-EU and non-ACP sources would also be useful. If inputs from new members of the European Economic Area and beneficiaries of the EU's GSP system were also allowed under the cumulation rules, it would enhance

opportunities for ACP states to produce efficiently.

In addition, the ACP-EU Customs Cooperation Committee should be made more effective to ensure that requests on the eligibility of individual products to the rules of origin get rapid treatment.

Options for the Medium Term

If shorter-term actions are successful in increasing the utilisation of existing trade provisions, then medium and longer term strategies of ACP states should emphasise successful operation in the global trade environment. The priorities are to improve export efficiency, to enhance the competitiveness of ACP products, and to diversify ACP exports into new products and new markets.

1. Give priority to trade development.

Apart from exploiting aid for trade as mentioned above, a more appropriate trade environment is needed in each country. This requires both physical arrangements, such as improved infrastructure and the establishment of an effective trade promotion organisation, as well as changes at the policy level. These include commitment to more outward-looking trade policies and increased involvement of the private sector in the formulation of trade policies. In some countries such as Jamaica, the private sector already has a relatively close relationship with government, and it plays a significant role in identifying the needs for a good business environment. Here, ACP states can also learn some lessons from the "East Asian Miracle" and integrate private concerns into public policies.

2. Establish attractive environments for private investment.

While integrating the business community into trade policy decision-making would already have a positive effect on private

investment in ACP States, more can be done to attract foreign and domestic investors. Appropriate policies, such as fiscal incentives to attract investors, and a good institutional framework to deal with foreign direct investment are needed. Here, useful lessons can be learned from the way that Mauritius successfully attracted Asian investors.

However, it has to be recognised that political and economic stability in ACP States is essential in attracting this investment. In countries where a favourable investment climate is already present, the EU should encourage European investors to increase their involvement in them. This can be done by introducing fiscal incentives or special projects that stimulate joint ventures between ACP and European investors. The European Community Investment Partners (ECIP) initiative for the Asian, Latin American and Mediterranean countries is a good example of such a scheme.

3. Invest in human capital.

While the training centres mentioned earlier focus on the Lomé provisions, for the medium term, it is essential to invest in broader educational opportunities.

To keep up with progress in global markets, opportunities for education and training in production technology, marketing, trade policies, and management need to be extended. For the latter, regional and national management institutes are well placed to organise courses with a particular sectoral focus that will also enhance entrepreneurial skills.

Twinning arrangements and exchanges of experience among ACP states are other ways to strengthen human resources and build useful external contacts and linkages.

4. Strengthen the ACP position in the international trading system.

ACP countries need to become better-equipped and better-prepared to play an active role in international trade negotiations. The EU can assist in this by making technical assistance available.

Apart from strengthening national negotiating capacities, it is important that the

ACP group defend their collective interests in the international trading environment. More states should therefore join the World Trade Organization. Communication and coordination among the states need to be improved -- the ACP Secretariat can play a useful role in this area.