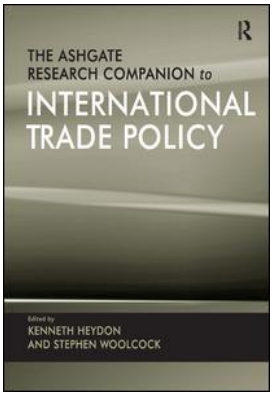

The Ashgate Research Companion To International Trade Policy

Kenneth Heydon, Stephen Woolcock

Trade Preferences for Developing Countries: The Case of the European Union

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Christopher Stevens
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Christopher Stevens

Introduction

All industrialized countries offer 'trade preferences' in the sense of multiple import regimes offering different levels of market access to different countries but those of the European Union (EU) and its predecessors are particularly complex. As such, the EU offers a valuable case study for a more general phenomenon. But detail is all important. The EU case illustrates the difficulty of calculating the economic effects of a particular change to a trade policy that already includes multiple layers of market access. But applying these lessons to other countries requires detailed information on the differentiated trade practice of each, which is a point to which we return in the conclusions.

The original Six inherited colonial trade preference schemes from France, Belgium and Italy, and the UK extended these when it joined. Originally these were reciprocal – the beneficiaries had to accord preferential access to the colonial power and, later, to the Six. During the 1970s–90s, these were largely replaced by non-reciprocal agreements requiring no trade quid pro quo. Since then two parallel systems (with porous borders) have emerged: on the one hand there has been a shift back to reciprocal accords, justified in the WTO as free trade areas (FTAs); on the other, the system of non-reciprocal preferences has been reinforced in certain respects.

This chapter covers both the reciprocal and non-reciprocal accords because the trade effects of Europe's actions under both systems are the same. The overall economic effects of reciprocal and non-reciprocal arrangements differ, since the former also involve policy changes by Europe's partner(s), but there is no difference on the EU side. Both systems give rise to a set of economic questions (do they, for example, create or divert trade?) and of political questions (are they, in Bhagwati's celebrated aphorism, 'building blocks or stumbling blocks' to multilateralism?).

We return to these questions at the end of the chapter and find that they are not straightforward to answer. The very complexity of the EU's preference system makes it a particularly illuminating case study for the way in which non-multilateral trade agreements create multiple (and sometimes conflicting) effects at different levels. The complexity (absolute and relative to other developed countries) can best be illustrated by reference to Africa. The EU has no fewer than 13 different preference agreements with Africa whilst the United States has four, while Australia, Canada, Japan and Norway have three apiece[1] (Stevens and Kennan 2011). Consequently, it is a country's position in the hierarchy relative to its competitors that is the fundamental determinant of the trade effects of its preferences. And, if the pack is shuffled, so are its trade effects. The last decade has seen a lot of shuffling.

The Evolution of the European System

Francophone states in North and sub-Saharan Africa were the principal beneficiaries of this system until 1975 when they were joined by some of the UK's former colonies and the Africa, Caribbean and Pacific (ACP) group was created (Lister 1988, 1997). The access of ACP goods exports to the European market was determined by the provisions of the Lomé Convention which was signed in 1975 and renegotiated three times until it was superceded in 2000 by the Cotonou Partnership Agreement (CPA). In its early years, Lomé was at the apex of Europe's 'pyramid of privilege' in the sense that a wider range of its actual and potential exports entered the European market at lower tariffs than did those of any other trade partner.

Alongside was a set of bilateral non-reciprocal preferential trade agreements with most Mediterranean countries which offered market access that was very liberal but more closely tailored than the Lomé Convention. The main restrictions were on access for products falling under the Common Agricultural Policy (CAP), which was limited broadly to traditional volumes of traditional exports, and the absence of the Lomé guarantee of unlimited tariff and quota-free access for non-CAP goods.

The third main plank in the EU's trade regime for developing countries was the Generalized System of Preferences (GSP). Following an initiative in the United Nations Conference on Trade and Development (UNCTAD) and justified in the

[1] The EU has six interim Economic Partnership Agreements or EPAs (all of which are different) with some sub-Saharan African states, bilateral agreements with Algeria, Egypt, Morocco, South Africa and Tunisia, and trades with others under either EBA or the Standard GSP. Canada and Japan offer GSP to almost all African states (and most-favoured nation or MFN to those not eligible), with a special tranche for LDCs. Most but not all African countries are eligible for the United States' GSP (with the rest trading on MFN terms), and some benefit from the additional provisions for LDCs. In addition, a group of sub-Saharan states is eligible for The African Growth and Opportunity Act (AGOA), with some 'lesser developed' states benefitting for extra preferences on apparel.

General Agreement on Tariffs and Trade (GATT) and World Trade Organization (WTO) by the 1979 'Enabling Clause', all the developed countries have created a GSP that offers lower tariffs on some of their imports from developing countries. All of the GSPs are 'autonomous policies' of the developed countries concerned (that is they have been designed and agreed voluntarily by each state acting alone) and so all are different in their details.

Europe's GSP began life as the poor relation of its trade preferences for developing countries (Stevens 1981). It covered fewer products than either Lomé or the Mediterranean accords and often imposed higher tariffs. Moreover, some developing countries were 'graduated out' either of the whole scheme or of eligibility for goods in which they were deemed to be too competitive. Consequently, whilst all developing countries were eligible for the GSP it was used in day-to-day commerce only by those that did not have superior access under one of the other regimes.

History and trade pragmatism initially determined which countries were covered by which regimes. All of the parties to the more preferential regimes had been European colonies but not all former colonies were offered membership. The ACP states were mainly small (economically if not geographically) because Britain's larger and more competitive former colonies, primarily those in South and South East Asia, were ruled out of Lomé eligibility (as were the Commonwealth developed countries that had preferential access to the UK market before it joined the European Community). Also in the group of developing countries only eligible for the GSP were those that had not been colonies of the Six or UK, most notably all of Latin America. A consequence of this eligibility pattern was that the EU could claim a majority of the poorest *countries* were covered by its most liberal preferences whilst critics could argue that the majority of the poorest *people* were served only by the least liberal tier.

After the early 1990s this pattern began to change as the GSP developed internal differentiation. Initially, there was a scheme to offer extra preferences to Central American and Andean states. It was justified as support for their struggle against the narcotics trade, making it well received in Washington as well as Madrid. This tranche was wider than 'the Standard GSP' (more products were covered) and deeper (tariffs were lower). Then in 2001 the EU launched the Everything But Arms (EBA) scheme under the GSP. This provides duty-free and quota-free (DFQF) access for all exports from least developed states (LDCs), albeit with a transition period for bananas (to 2006), rice and sugar (to 2009).[2] Finally in 2005 the special tranche for the Central American/Andean states was transformed into a broader GSP+ regime available to a wider group of developing countries but still excluding MERCOSUR and most of South, South East and East Asia (Stevens 2007). Despite the differences, one common feature of all the regimes is that they are non-reciprocal, that is, the beneficiaries are not required to offer any special regime to European exports in return.

[2] In addition, special tranches were introduced for countries adhering to international labour and environmental conventions but these were barely used until given a new lease of life by the incorporation of their broad approach into the GSP+.

The result was a more complex pattern of trade preferences. The non-reciprocal Lomé/Cotonou regime was joined at the apex by EBA, with GSP+ close behind and, in a parallel development, Europe began to negotiate reciprocal FTAs with its close neighbours and with South Africa, Chile and Mexico. It also did so with its Mediterranean partners to replace the non-reciprocal accords.

This created, in broad terms, a three-band inverted pyramid of privilege. At or near the apex were a large number of states that had liberal access to the European market for their goods exports under either a non-reciprocal preference agreement or an FTA. In the middle were those developing countries eligible only for the Standard GSP. The base comprised primarily the small number of Organisation for Economic Cooperation and Development (OECD) states not covered by an FTA,; these states export to the EU under the misnomer of the GATT/WTO 'most-favoured nation' (MFN) regime and pay the highest tariffs.

Most recently, there have been two changes resulting in a sharp move of states from the non-reciprocal to the reciprocal groups (but no great change in membership of the three bands). First, the CPA trade regime came to an end on 31 December 2007 (though the other aid and political aspects of the Agreement continue until 2020). The ACP split into a group of 36 states that initialled reciprocal Economic Partnership Agreements (EPAs) and the rest for which access remained non-reciprocal but under the GSP.[3] Second, as the Doha Development Round of multilateral trade agreements stagnated, the EU began actively to negotiate FTAs with a range of important developing country trade partners. These include the Central American and Andean states to replace their non-reciprocal GSP+ as well as countries like South Korea (that are not eligible for the GSP) and India, with the long-running negotiations with MERCOSUR also given a boost.

GATT/WTO Compatibility

The GATT and WTO have played a key role in the shaping of the EU's pattern of trade preferences. Some elements remain controversial because of an inherent feature of the multilateral system of trade rules. This is that the conformity of specific Member State policies is determined, if at all, *ex post* rather than *ex ante.* Only if one Member challenges the policy of another under the dispute settlement provisions will conformity be adjudged, and then only if the two parties fail to reach a compromise solution during the earlier, conciliation stages of the process. Until then, a Member may apply any policy that it believes, or chooses to believe, is in conformity without any official, independent assessment of the merits of the case.

[3] Seventy-six of the ACP states took part in the negotiations. Of the 35 states that initialled, most have gone on to sign either full or interim EPAs but, at the time of writing, negotiations were continuing with seven initialling states plus South Africa, which failed to initial. There were also continuing negotiations with many of the other ACP states but without any strong indication that they would sign.

Until the mid-1990s, the EU justified the conformity of its preferences with multilateral rules by mere assertion that they were covered by the provisions dealing with special and differential treatment (SDT) in favour of developing countries. In this the EU was acting no differently than some other developed states: several North–South non-reciprocal preferential trade agreements are still justified by the parties in the same way. But for Europe this claim was put to the test in multilateral dispute settlement, in relation to the Lomé Convention, and ruled to be invalid. This has had a profound effect on the evolution of the EU's trade policy.

Banana Disputes

The trigger setting the process in motion was a 1993 GATT judgment on the legality of the European banana trade regime which was, in turn, 'collateral damage' from the completion of the Single European Market (Stevens 2000). Prior to 1992 the EU did not have a common trade regime for bananas. Separate regimes existed (largely reflecting colonial legacies) which resulted in markedly different prices in member states. They were made possible by a provision in the Treaty of Rome (Article 115) that permitted member states to restrict imports from their partners of goods that originated outside the Community. Coupled with the oligopolistic nature of the trade in bananas, this allowed the UK, France and Italy to restrict imports of cheaper Latin American bananas (both directly and via another member state) until their markets had absorbed all of the more expensive fruit exported by ex-colonies (and overseas Départements).

Because the Single Market allowed cheaper fruit imported into other EU states to be transhipped to UK/France in competition with the 'colonial fruit', the old regime had to be replaced with one that would impose sufficient restrictions on imports from the most efficient suppliers (in Latin America) to remove the incentive for such producers to take over the market share of the former colonies. The result was a three-tier tariff (zero for the ex-colonies, low for Latin America within a quota and high outside the quota) which became the subject of a series of GATT and WTO disputes, all of which the EU lost.

The Three WTO 'Pegs'

In the first of the adverse judgments, the GATT panel concluded not only that the banana regime was contrary to the rules but also that the same applied to the entire Lomé Convention. The search was on to find a regime that would be less open to multilateral challenge.[4] There are three 'pegs' on which GATT/WTO Members can

[4] In principle requests for a waiver had to be approved by 75 per cent of members, but in practice the GATT worked on the basis of consensus (as does the WTO), and so in reality all members must at least acquiesce in any request for it to go forward.

hang their justification for breaching the MFN principle and treating some trade partners more favourably than others. One is to obtain a waiver from the 'normal' rules. Up until and during the 1990s, waivers were the 'solution of choice' for North–South trade agreements like the United States' Caribbean Basin Initiative (CBI) and Canada's Caribcan regime, and the EU's first response to the adverse GATT panel ruling on Lomé was to seek one. A waiver was obtained initially for 1995–2000 and, then, until 2007 to cover a transitional phase under the CPA whilst EPAs were negotiated. But waivers which had been approved largely without contention in the GATT became increasingly difficult to obtain in the more litigious atmosphere of the WTO. It took the EU until 2002 to obtain the extension of the waiver as part of the deal to launch the Doha Development Round and it was required to 'compensate' Thailand, Philippines and Indonesia by offering them improved fisheries access. With the banana dispute rumbling on, DG Trade was very reluctant either to seek a new waiver or to allow the existing one to expire in 2007 without an alternative being in place.

The EU's strong preference was that the replacement for the CPA trade preferences should be a regime hung on the second WTO peg – the provisions for the creation of FTAs and customs unions in Article XXIV of GATT 1994 for trade in goods and Article V of the General Agreement on Trade in Services (GATS) for services. Two key provisions of Article XXIV stipulate how much trade must be liberalized and how quickly for an agreement to qualify as an FTA or customs union. In the case of FTAs, 'substantially all the trade' between the parties must be liberalized (paragraph 8) within a period that should be a 'reasonable length of time' (paragraph 5), which the Understanding on Article XXIV specifies should exceed ten years 'only in exceptional cases'. Article V of the GATS 1995 applies analogous rules on the extent to which services trade must be liberalized.

Whilst this phraseology may appear straightforward, Article XXIV actually poses considerable challenges of interpretation which means that unless and until a case reaches adjudication through the WTO's dispute settlement process, alternative interpretations can coexist. One thing seems to be clear: 'substantially all' trade is less than 'all trade'. Some products need not be liberalized – but how many? The European Commission interprets 'substantially all trade' as requiring a liberalization of around 90 per cent on average of the total value of trade between parties which can be achieved asymmetrically with one party liberalizing by more and the other(s) by less than this figure. Most recent EU agreements meet this threshold (see next section).

The final WTO peg is the 'Enabling Clause' which underpins the GSP because it allows developed countries to grant unilateral preferential treatment to all developing countries or to recognized subgroups. Whilst the requirements for fulfilling Article XXIV have not been established precisely through adjudication, the WTO's dispute settlement system has given some guidance in relation to the GSP. The least liberal 'Standard' tranche of the EU's GSP very probably meets the requirements since it is available to all developing countries as does EBA since the LDC group is a recognized WTO category of country. But there is uncertainty over GSP+ (Bartels 2007).

The GSP+ had its birth in a case brought against the EU in 2002 by India, provoked by the extension in 2001 of the GSP's antinarcotics tranche to Pakistan (EC 2001). The essence of India's case was that the antinarcotics regime violated GATT Article 1.1 (on non-discrimination) and that countries could not discriminate within their GSP schemes between different developing countries.[5] The EU's primary defence was that the discrimination was justified by the Enabling Clause. In its judgment, the WTO Appellate Body rejected one part of the Indian argument – and in so doing established important 'case law' on the allowable features of GSPs. It did not accept the Indian argument that the Enabling Clause required tariff preferences to be identical for all beneficiaries. Rather, it asserted the legitimacy of providing different preferences provided that the difference responded to a widely recognized 'development, financial [or] trade need' (WTO 2004a: paragraph 164). It gave as examples of such 'broadbased recognition' cases 'set out in the WTO Agreement or in multilateral instruments adopted by international organizations' (paragraph 163), a formulation that would seem to secure the legitimacy of the LDC group and, hence, EBA.

But the Appellate Body then went on to uphold the specifics of the Indian challenge to the EU's higher level preferences for Pakistan because the EU's antinarcotics regime failed to satisfy this criterion: the beneficiaries did not share a widely recognized trade need that bound them together as different from all non-beneficiaries. Subsequent arbitration resulted in the EU being asked to amend its trade policy by 1 July 2005 (WTO 2004b).

The principle result of this amendment was the creation of the GSP+ as the third tranche of the EU's GSP scheme. Like the preceding antinarcotics regime it offers preferences to a specific group of eligible states that are broader and deeper than those available under the Standard GSP. The key question – which may remain unanswered definitively unless and until a case is taken to WTO dispute settlement – is whether this eligible group shares 'a widely recognized trade need'. There are three eligibility criteria for GSP+. One is that beneficiaries must ratify and implement a set of international social, labour and environmental conventions; the EU argues that the 'extra' preferences assist countries to meet the costs incurred. The others are more controversial: exports must not be too 'diversified' and the economy must be relatively small. Both are established by a formula that effectively excludes from eligibility, regardless of their social, labour and environmental stance, a swathe of countries in South and South East Asia and MERCOSUR, including some with lower gross national products (GNPs) than those of beneficiaries. Since this formula is not used by any other developed country or by the EU in any of its other classifications of developing countries, there must be some doubt that it meets the Appellate Body's requirement of a 'widely recognized' category of countries.

[5] Initially India challenged all of the high level GSP preferences other than EBA, but it then concentrated on the antinarcotics regime and reserved its position on the other two.

Diversity Continues

At one level, the EU preference system has become simpler. With the end of the CPA trade regime and the renegotiation of the Mediterranean agreements there is now only one vehicle for non-reciprocal preferences: the autonomous, non-negotiated GSP. All other preferences are now reciprocal and have been negotiated. This sharp polarization between non-reciprocal and autonomous on the one hand and reciprocal, negotiated on the other did not exist before 2008.

At a deeper level, though, the diversity continues. There are differences between the reciprocal agreements, and a new set of rules of origin introduced in 2010 establishes further differentiation in the GSP.

The FTAs

The EU Commissioner for Trade, Karel De Gucht, has argued that:

> The EU has an active negotiating agenda with developing countries from all corners of the globe … These agreements are not identical. There is no identikit model agreement that the EU seeks to impose on partner countries. (de Gucht 2010)

Whilst this is an accurate statement since all the FTAs are different in their details, there are some clear patterns on core features. One is that the scope and rigour of the agreements has tended to grow over time. The Euro–Med agreements negotiated mainly in the 1990s[6] are quite limited both in scope and enforceability. The 2000 Trade Development and Cooperation Agreement (TDCA) with South Africa liberalizes a large proportion of trade within a stated timeframe and has strong provisions on competition policy, but for most other areas of trade policy it offers only a framework for further negotiations; enforcement mechanisms are weak. The 2002 Chile agreement has more extensive coverage and more closely delineated enforcement provisions as well as operational provisions on sanitary and phytosanitary standards (SPS). The one full EPA (with a grouping of the Caribbean Community (Caricom) and the Dominican Republic, known as the Caribbean Forum or CARIFORUM) also has wide, enforceable provisions. The interim EPAs (with all the other signatory states) are also foreseen as covering more than trade in goods, but so far negotiations have not proceeded far (and may never do so).

Most, but not all, of the more recent agreements include enforceable dispute settlement. Even though they are rarely activated, the provisions on dispute

[6] Association Agreements with Tunisia (1995), Israel (1995), Morocco (1996), Jordan (1997), the Palestine Authority (1997), Algeria (2001), Lebanon (2002), Egypt (signed 2001, entered into force 2004), Syria (initialled 2009).

settlement underpin the enforceability of any agreement. If they are weak or lacking, the agreement is no more than the expression of good intentions. Even if never actioned, the combination of measurable obligations with a system for imposing penalties for noncompliance is likely to have an impact at least on the extent of commitments made in the agreement. The provisions of the early Euro–Med agreements 'are very loosely formulated' (ECDPM 2004: 2). They combine wide discretion with an absence of time limits for specific steps to be taken, which provides considerable latitude to delay indefinitely the hearing of a complaint; even if adjudication does take place, there are no provisions for penalties in case of noncompliance. The TDCA sets clear (albeit leisurely) time limits for the adjudication process but it also fails to specify the remedies available to a complainant if the other party fails to take appropriate action following an adverse judgment. By contrast, the Mexico, Chile and Korea agreements as well as most of the EPAs provide detailed procedures, timeframes for the relevant steps, and sanctions in the form of a suspension of benefits from the agreement.[7]

The extent of EU liberalization on goods in these agreements is closely linked to the *status quo ante*. In all of the EPAs it has given DFQF immediately on initialling of the accords and in the Euro–Med agreements it has continued significant pre-existing access on sensitive products. In none of the other FTAs has it done so. In its statements concerning the TDCA the EU claimed that it was liberalizing 95 per cent of its imports. Although such a figure is unverifiable (since no base year is given) and needs to be interpreted in the light of a county's overall tariff pattern,[8] in this case it accurately reflects the fact that a relatively small number of sensitive agricultural, processed agricultural, industrial and manufactured goods are either excluded from liberalization altogether or subject to tariff quotas (TQs). In the Korea agreement, the EU's liberalization is complex and partial. Apparently substantial (and in many cases quick acting) removal of *ad valorem* EU agricultural tariffs is partly offset by a different calendar for the removal of excise duties and the entry price system. Similarly, the EU's agricultural liberalization is limited towards Chile and very limited for Mexico.

Although the liberalization made by the EU's partners varies widely, when seen alongside Europe's liberalization the picture appears broadly consistent with the EU position in the WTO that the Article XXIV requirement of 'substantially all' trade being liberalized is met if by the end of the implementation period tariffs have been removed on a basket of goods representing 90 per cent of the value of total trade.[9] By contrast, recent agreements are harder to reconcile with the Article

[7] The exceptions are the interim EPAs with the East African Community (EAC) and Eastern and Southern Africa (ESA).

[8] A point best illustrated by reference to a hypothetical state with only two tariff levels: zero and so high as to choke all imports. It could, theoretically, liberalize 100 per cent of imports without improving access for a single good since the excluded products would account for 0 per cent of imports.

[9] The position is only 'broadly consistent' as it takes no account of bilateral trade balances. If each party accounts for half of trade, the 90 per cent target is met by the EU

XXIV requirement that implementation should only exceed ten years in exceptional circumstances. The time allowed for completing liberalization in the EU's FTAs has been getting longer. In the Mexico and Chile FTAs both sides had up to ten years. In the TDCA the EU committed to completing its liberalization in ten years and South Africa to 12 years. But the implementation periods for the EPAs range from 15–25 years from the date of initialling.[10] In the Korea agreement the EU will complete its liberalization in five years but Korea has up to 20 years.

All of the recent agreements prohibit quotas (unless they are specifically listed and admitted in the document) and what can be called 'para-tariffs' (charges on imports not defined by the imposing country as a tariff but not fulfilling the criteria set out in the agreements for exempt taxes). Export duties are also restricted.

There are services and investment chapters in most of the EU's agreements (and also in the CPA) but only the Chile, CARIFORUM and Korea FTAs include substantial provisions that potentially go beyond GATS obligations and, in the case of the Mexico agreement, stand still.[11] The provisions are highly context-specific, which makes generalization about their scope impractical, but one common, structural feature of the FTAs is that they provide a single set of covers for what are, effectively, a set of bilateral commitments (40 of them in the case of the CARIFORUM EPA) that combine common general principles and provisions with a host of national exceptions. This flows from the EU's limited shared competences in non-goods trade that applied when these accords were negotiated (and may change as a result of the Lisbon Treaty) plus, in the case of the EPA, the non-shared competences of CARIFORUM.

There are provisions in several agreements that refer to one party offering improved treatment to the other if it negotiates an agreement with a third party. The section of the Mexico agreement on government procurement, for example, includes the commitment that 'In the case that the Community or Mexico offer a GPA or NAFTA Party, respectively, additional advantages with regard to the access to their respective procurement markets beyond what has been agreed under this Title, they shall agree to enter into negotiations with the other Party with a view to extending these advantages to the other Party on a reciprocal basis' (Article 37).

liberalizing on 100 per cent of its imports and the partner by 80 per cent of its imports. But, as calculations by the Commission during the course of the EPA negotiations made clear, some partners have a trade surplus with the EU and so need to liberalize on more than 80 per cent since their tariff cuts apply to over half of the value of trade (and vice versa for countries with a trade deficit). These calculations dropped out of Commission presentations during the course of the negotiations.

[10] Unlike most of the other agreements which express the liberalization calendar in terms of number of years after the agreement comes into force, the EPAs use actual dates. A consequence is that the delay between initialling and signature has reduced the time available after the agreement comes into force. The members of the Southern African Customs Union will complete liberalization more quickly because they are affected either de facto or de jure by the TDCA implementation period, which expires in 2012.

[11] There is provision in the other, interim, EPAs for the parties to negotiate services provisions but the outcome is uncertain.

It is in the EPAs, however, that the MFN clause is most fully developed – and exhibits some potentially important differences in the detail. The core standard provision for goods (using the CARIFORUM EPA as the source for quotes) is that 'With respect to matters covered by this Chapter, the CARIFORUM States or any Signatory CARIFORUM State shall accord to the EC Party' more favourable treatment resulting from 'the CARIFORUM States or any Signatory CARIFORUM State becoming party to a free trade agreement with any major trading economy after the signature of this Agreement' (Article 19.2).

Another common provision is the definition of a 'major trading economy' as being:

> Any developed country or any country accounting for a share of world merchandise exports above 1 per cent in the year before the entry into force of the free trade agreement referred to in paragraph 2, or any group of countries acting individually, collectively or through an free trade agreement accounting collectively for a share of world merchandise exports above 1.5 per cent in the year before the entry into force of the free trade agreement referred to in paragraph 2. (Article 19.4)

One area of difference is what happens when both sides of the new agreement are more favourable. Most of the MFN clauses specify what will happen in such cases, but the texts of the East African Community (EAC) and Eastern and Southern Africa (ESA) EPAs are silent. Where it can be demonstrated that the better-than-EPA treatment accorded by the ACP party is reciprocated by treatment from its partner that is 'more favourable' (in the CARIFORUM agreement) or 'substantially more favourable' (in the others) the procedure (using the Pacific EPA text Article 16.3) is that 'the Parties will consult and may jointly decide how best to implement the provisions'. No definitions are offered for either 'more favourable' or 'substantially more favourable'.

Another difference with potential importance if a case goes to dispute settlement lies in the definition (or lack of it) of a 'free trade agreement' (or 'economic integration agreements', which is the term used in the Central Africa and EAC texts). This remains undefined in the CARIFORUM and Southern African Development Community (SADC) texts but the others specify (citing the Ghana EPA Article 17.5) that the term

> 'free trade agreement' means an agreement substantially liberalising trade and providing for the absence or elimination of substantially all discrimination between or among parties thereto through the elimination of existing discriminatory measures and/or the prohibition of new or more discriminatory measures, either at the entry into force of that agreement or on the basis of a reasonable time frame.

These differences could prove to be important since it remains to be seen how these clauses will be applied in practice given that there exists considerable ambiguity.

What counts as 'more favourable treatment' by the ACP party in an agreement that may have some parts that are less good and some that are better? What happens in cases where the 'more favourable treatment' by the ACP party is in return for treatment by the other that is also more favourable than the EPA? Will it apply to South–South agreements notified to the WTO under Part IV (as expressions of SDT) rather than Article XXIV in those EPAs that do not contain a definition of a free trade/economic integration agreement? Answers to such questions will become clear only as the MFN clause is applied either autonomously by one party or following a dispute judgment.

Only the CARIFORUM EPA has enforceable provisions on environmental, labour and social standards, but it is hard to see any parts of the relevant text (Title IV Chapters 4 and 5) that are expressed in sufficiently precise terms for an infraction to be easily identifiable. Moreover, the use of trade remedies (that is the suspension of preferences) against an infraction is explicitly ruled out. There is a chapter on Trade and Sustainable Development in the Korea agreement but this states explicitly that it is not the intention of the parties 'to harmonise the labour or environment standards of the Parties' but only to strengthen their trade relations and cooperation in ways that promote sustainable development (Article 13.1.3). There are pledges to abide by named international conventions and for expert consultations in cases where one party has a problem. But, crucially, such consultation is instead of, and not additional to, the overall provisions on dispute settlement (from which this chapter is explicitly excluded – Article 13.6) and no provision is made for remedies.

New GSP Rules of Origin

Rules of Origin (RoO) are the 'small print' of preference agreements. They establish where a good is produced and therefore what tax is paid (or other rules applied) when it is imported. Any favourable treatment promised in a preference agreement applies only to goods that meet the rules. Changing the rules will change the benefits.

The current regimes have been under review since December 2003, when the European Commission presented a Green Book on the revision of the preferential RoO. Following consultations with the private sector and other stakeholders, the Commission presented, on 16 March 2005, a communication on the future of the RoO which aimed 'to make rules simpler and, where appropriate, more development friendly'. (EC 2005)

The structure of the current rules is the same in all of the EU's preference regimes although the detailed provisions differ (even between the EPAs). The GSP and all of the FTAs identify on a product-by-product basis the processing that must be applied to non-originating inputs in order for them to acquire originating status. No single criterion applies in all cases: the requirements are expressed as either

a change of tariff heading, or a specific process/action to be undertaken, or a percentage contribution to the ex-works price or some combination of these.

After much internal wrangling within the EU, a set of changes to the rules was finally proposed in 2010 (EC 2010). The initial 2005 initiative would have applied the new rules to the GSP, the EPAs and, in due course, all of the EU's preferential agreements. But the 2010 regulation applies only to the GSP. This is because only the GSP can be amended unilaterally by the EU; all of its other accords are negotiated and any changes to the RoO would need to be agreed by its partners. Although originally billed as making the rules 'simpler', the new regulation actually extends the internal differentiation within the GSP by introducing some rules that are different for LDCs and non-LDCs. The former, for example, can now claim originating status for exports of clothing produced from non-originating imports of cloth – putting them in the same position as EPA signatories and lesser developed African states exporting to the United States under AGOA.

The most fundamental change would have been on the criterion for establishing originating status. The Commission proposed in the 2005 communication to replace the current mix of criteria for establishing whether an exporter has undertaken 'sufficient processing' by value added as the normal criterion. Depending on the level at which the value added threshold was set, this could have altered substantially the ease with which the rules could be met and, hence, the practical value of the GSP preferences. But the new regulation, whilst expressing a marked enthusiasm for the value added criterion, allows multiple criteria to continue.

Building or Stumbling Blocks?

How do the EU's preferences relate to multilateral rules and liberalization? Do they create or divert trade? Both questions require answers that are to a large extent qualitative and judgmental. That may seem more self-evident with the first question than the second. In the absence of a clear counterfactual, any assessment of what the EU *would have done* in the GATT/WTO had it not pursued so many bilateral and plurilateral accords must necessarily rely on informed inference from observation. Trade creation and diversion, by contrast, have been widely studied through rigorous quantitative analysis, and it is clear that even in respect of the EU's accords they provide a part of the answer. But the volume of detailed trade data and assumptions needed realistically to model the multilevel effects of changes to EU trade policy is so great that it is only a very partial guide.

The EU's Pragmatic Preference Making

The EU's pattern of preferences has all the hallmarks of having been created by a pragmatic reaction to events rather than a strong guiding strategy. A strategy has been apparent, inherited from colonial links and the EU's perception of itself

as a champion of regionalism, but it has been overlain (heavily at times) by more pragmatic concerns. The creation of EBA and GSP+ provide two illustrative examples.

When EBA was developed by DG Trade, amid considerable secrecy (with DG Agriculture reportedly 'consulted' only at the end of the process), it was widely perceived as having as its target not only LDCs but also the European common agricultural policy (CAP), especially for sugar which, until then, had proved to be remarkably impervious to change. In the months following its launch, three normally competing lobbies made common cause to oppose the proposals on sugar: the EU beet producers, the cane refiners and the ACP cane exporters. By setting a deadline for DFQF imports of sugar from LDCs it made reform of the CAP for sugar (which was based on controlling supply into the European market) inevitable since a continuation of the old regime could have become financially unsupportable.

Without the CAP perspective, EBA appears to have been an exercise of pure idealism (to favour LDCs) and strategic incoherence (since it greatly weakened the EU's policy of replacing CPA preferences with EPAs). The EPA negotiations were unusual in the sense that they did not involve to any significant degree the exchange of trade concessions that is normal both multilaterally and bilaterally. Because the EU provided the ACP with liberal market access under the CPA, it had only limited scope to make substantial additional commitments on goods as part of an EPA deal in return for the ACP accepting reciprocity. At the heart of its negotiating strategy, therefore, was a threat to ACP non-signatories that they would suffer a deterioration in their access to the European market after the end of the CPA trade regime by being downgraded to the GSP. But EBA removed much of the sting from this threat for ACP LDCs. Not surprisingly, almost all of the states that have declined to initial an EPA are LDCs.[12]

The GSP+ was introduced rapidly to replace the antinarcotics regime following a WTO judgment. In order to make it reasonably broad-based, the Commission's communication of March 2005 gave countries wishing to be considered until end-October 2005 to ratify any 'missing' conventions and apply. But this would have led to a hiatus in higher level preferences for the Latin American beneficiaries of the antinarcotics regime after this ceased by the WTO's 1 July 2005 deadline. The EU therefore provided that 14 states would receive GSP+ immediately on a provisional basis even before applying – since they already fulfilled the criteria (European Council 2005: Preamble 8). Yet three of these states appeared not to have met at that time the criteria in terms of convention adoption whilst others that had done so were not included in the list of provisional beneficiaries.

The EU's higher level preferences are now so extensive that it would be more accurate to refer instead to a system of discriminations. Over the past two decades the EU has responded pragmatically to the pressures put upon it in a way that

[12] The non-LDCs that had failed to initial at the time of writing all export goods that mainly face low or zero EU MFN tariffs. There are country-specific reasons why each of the ten LDCs that initialled did so.

manages market opening to maintain greater restrictions on countries deemed to be most competitive than on others. Liberalization on sensitive goods has been undertaken initially for the least competitive global suppliers and then, over time, generalized to a wider and wider group. On this interpretation, multilateral liberalization occurs at the end of this process when the EU is willing to liberalize towards the largest or most competitive suppliers. One consequence is that the 'middle' tier of the inverted pyramid of privilege now comprises primarily countries in South and South East Asia and MERCOSUR, which face relative discrimination vis-à-vis almost all developing and many middle-income states. The EU is currently seeking to negotiate FTAs with most of these states that would offer reciprocal gains in return for, probably, carefully crafted liberalization.

Different Types of Trade Diversion

It is conventional when showing analytically their potential effects for FTAs and non-reciprocal preferences to be compared with a *status quo ante* in which preferred and non-preferred states are treated equally. Hence, the removal of barriers to imports from preferred states can either 'create trade' (if the now cheaper imports displace domestic production) or 'divert trade' (if they displace imports from more efficient suppliers that still face full tariffs). But very few of the EU's changes have taken place against such a *status quo ante*. When shuffling moves a country 'up' the pyramid, it creates (or extends) a relative advantage over countries that were previously at the same level (or lower down). At the same time, such a move reduces any discrimination vis-à-vis countries that are higher up. In other words, the change will produce both new trade diversion and remove earlier diversion.

Creating two additional categories, of positive 'diversion removal' (DR) and negative DR, helps to understand the range of likely effects. Positive DR occurs when a country moves up the pyramid and there is an erosion of the preference previously enjoyed by a competitor (and there is enhanced diversion against any competitor that has not been elevated). Most of the DR created by the shuffling over the past decade has been of the positive kind, but some has been negative. This occurs when a country is moved down the pyramid. So far it has occurred only in relation to the small number of non-LDC ACP states that have not initialled EPAs and now export to the EU under the standard GSP. More widespread negative DR has been avoided so far by the EU's unilateral extension of DFQF to all those states that have initialled an interim EPA. But negative DR may increase in 2014 as the Commission proposes to remove the unilateral preferences for ACP states that haven't signed an EPA and to graduate all upper middle income states out of the GSP.

Each type of effect will produce a different impact from a given trade policy change on the level of imports, adjustment by domestic competitors and consumer gains. By definition, a policy change that results only in trade creation will result in the largest relative increase in imports, domestic adjustment and consumer gain

for any given level of tariff cut and price elasticity of supply and demand. The scale of trade diversion, as conventionally understood, and positive DR will be similar: there will be a relatively small increase in the level of imports and, hence, consumer gain. But whereas the loss for trade diversion is borne by competitive suppliers left out of the tariff change, under positive DR it is borne by uncompetitive exporters that previously enjoyed more favourable access. Negative DR, by contrast, will tend to result in a fall in imports (and no consumer gain). Those suppliers from which preferences have been removed will tend to reduce exports in the face of higher tariffs and there is no reason to expect any offsetting increase in imports from other suppliers given that their access terms have not changed.

Any specific trade policy change may encapsulate a bewildering combination of these different effects. Teasing out the various strands will often require knowledge of the market for very disaggregated product groups – who actually competes with whom, for example, on a specific type of grape juice that is treated significantly differently in GSP+ from the GSP? As with comparative advantage it may turn out to be easier to identify 'revealed' trade creation and diversion after the event by inferring measurable changes in flows to a previous change to trade policy. And for that, the large changes in EU preference policy are too recent to have fed through clearly into actual trade flows.

Conclusions

The complexity of the EU's preferential trade regimes for developing countries puts it at the extreme end of the spectrum, but it is not unique. Other developed countries also have overlapping regimes with a variety of esoteric qualifying criteria as well as, or instead of, income which are subject to frequent change. The United States has both a GSP and a set of other non-reciprocal regional agreements (such as the Africa Growth and Opportunity Act (AGOA) and several schemes known colloquially as the Caribbean Basin Initiative) as well as reciprocal FTAs. Canada has the Caribcan non-reciprocal regime for the Caribbean (and is currently negotiating an FTA) as well as its GSP. And some countries, whilst focussing preferences for developing countries on their GSPs, provide differentiation within it. Treating LDCs differently from other developing countries is commonplace but both Australia and Norway treat some non-LDC developing countries differently from others in their GSPs. As well as special provision for LDCs, Australia has a regime in its 2011 tariff schedules for most (but not all) LDCs plus 11 other countries most of which are Pacific states but which also include Botswana and Namibia. Similarly, Norway has since 2008 extended in principle a special regime for LDCs to 14 low-income countries (and has implemented this so far in eight of them).

Hence, the EU experience can be seen as having a broader significance for the analysis both of sub-multilateral trade policy change and for the development effects of preferences. But applying this guidance to the specificities of any particular

country's trade policy requires detailed knowledge of its trade regimes. The picture of a single, MFN trade regime applying in all WTO members is a mirage.

Both this detailed analysis of the EU's regimes and brief glance at those of other states suggest that the questions normally posed – trade diversion versus creation, stumbling versus building blocks – are either unanswerable or too narrowly specified. Whether or not world trade would be more disciplined and global welfare higher had the EU (and other developed countries) not deviated so much from the MFN principle is not a question to which a definitive answer can be given. A plausible case can be made in favour of the 'building blocks' case – but the opposite opinion is also valid. If the focus is on incremental change (rather than the whole sub-multilateral edifice), it is more feasible to offer a strong answer – but *only* if the specificities of both the proposed change and of the most plausible counterfactual are taken fully into account (which, again, introduces a basis for differing opinions). As with any such system built up pragmatically over decades, analysis often requires the creation of a set of stylized facts since reality is too complex. But these stylized facts must be very carefully constructed to avoid gross distortion.

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