Analytical Note
SC/AN/TDP/EPA/2
Original: English

FACT SHEET N° 2

THE VALUE OF EU PREFERENCES FOR THE ACP AND EPA CONTRIBUTION TO MARKET ACCESS

SYNOPSIS

This Analytical Note is part of a series of Fact Sheets designed to overview and assesses the development implications of the Economic Partnership Agreements (EPAs), which the EU is currently negotiating with 76 countries in Africa, the Caribbean and Pacific (ACP). The purpose of these Fact Sheets is to examine the existing material on EPAs and to provide an analysis of their potential impact on ACP countries. The Fact Sheets seek to increase the understanding of the substantive issues at stake in the negotiations, thereby enabling policy-makers, lobbyists and campaigners to make informed decisions about how to engage with EPAs.
This Fact Sheet analyzes the impact of the expiry of Cotonou preferences for ACP exporters.

March 2007
Geneva, Switzerland

These Fact Sheets are being prepared, published and disseminated by the **South Centre** as a contribution to the EPA debate. They build on research conducted by Mr. Mayur Patel, Doctoral Researcher in International Development, Oxford University. They have been financially supported by **OXFAM International**, but do not necessarily reflect Oxfam campaign positions.

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TABLE OF CONTENTS

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BACKGROUND:

1. Preferential access to the EU market for ACP producers, which is currently granted under the Cotonou Agreement, will expire in December 2007 with the end of the Waiver which ensured the compatibility of such preferences with WTO rules. To maintain preferential access for ACP countries in a WTO compatible manner, the EC has suggested the conclusion of "Economic Partnership Agreements" (EPAs), which would constitute a Free Trade Agreement (FTA) between the ACP and the EU and conform with related WTO rules. This arrangement will entail both sides liberalising and the EU fully liberalizing its markets to 100% of ACP exports.[1]

2. Since exports from the LDCs are already granted fully duty-free and quota-free access to the EU under the Everything But Arms (EBA) scheme, this option would be particularly interesting for non-LDC ACP countries - who benefit from preferential, but not fully liberalized trade[2], to the EU. However, access to the EU market raises two questions of strategic importance:

(a) Should ACP countries negotiate and conclude EPAs out of fear of losing their current preferences?
(b) Should the further liberalisation of EU markets be seen as an incentive for ACP to negotiate?

3. This fact sheet provides answers to both of these questions. Firstly, we assess the importance of current ACP exports to the EU and what ACP countries would lose in terms of market access, if they did not negotiate an EPA. Secondly, we assess how much more market access could be gained for ACP countries from an EPA.

I. PREFERENCES: THE RATIONALE AND THE DEBATE

[1] The EU has recently confirmed that it will grant fully liberalised access to all ACP imports, in other words, that it will extend the duty free and quota free treatment that LDCs currently enjoy in the EU to all ACP countries. "EU offers full market access to Africa, Caribbean and Pacific regions in EPAs negotiations". Press Release. Brussels, 4 April 2007.
[2] Under the Cotonou Agreement provisions over 97% of ACP exports enter the EU markets duty free.

4. Trade preferential schemes offer more favourable market access to exporters from selected preference receiving countries. In the context of Cotonou, this favourable access entails the EU providing lower tariffs ('duties') and lower quantity restrictions ('quotas') on goods from ACP exporters[3]. The EU's stated purpose for providing these preferences is to boost ACP exports and encourage productivity, growth and development.

5. However, despite receiving trade preference from the EU since 1975, exports from ACP countries to the world and to the EU have declined in comparison with those from other developing countries. Between 1975 and 1992, the share of ACP non-oil exports in EU imports dropped from 6.1% to 2.9%[4].

6. Indeed, there is some debate about the effectiveness of preferential trade agreements. Preferences can reinforce the dependence of recipient countries on a limited number of markets, encouraging the misallocation of resources away from efficient production towards activities that receive preferences. However, many countries suffer from major development inhibiting constraints, including small domestic markets, limited skills base, small island economies, and proponents of preferences argue that such countries require preferences as an incentive to engage in international trade[5].

7. Nevertheless, the poor performance of ACP exports should be also attributed to two main causes: the persistence of barriers to *market access*, and barriers to *market entry*.

a. The increasing use by the EU of non-tariff barriers, including health and safety standards, certification regulations, the restrictive rules of origin and problems of tariff escalation, have hindered the ability of ACP countries to expand and diversify their exports[6].

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[3] Other types of preferential access include guaranteed price arrangements. See, for example, the ACP exports of sugar to the EU.

[4] M. Davenport, A. Hewitt and A. Koning (1995), *Europe's Preferred Partners? The Lomé Convention in World Trade* (London: Overseas Development Institute) as quoted in M. Manchin (2006) 'Preference Utilisation and Tariff Reduction in EU Imports from ACP Countries', *The World Economy*, pp. 1243-1266.

[5] In some cases preferences have been an important contributor to the diversification of exports. For example, rice preferences led to the diversification of rice producers in Guyana into the transportation industry see FAO (2004) 'Small Island Developing States, Agricultural production and trade, preferences and policy', *Commodities and Trade Technical Paper* No. 7. Rome.

[6] P. Brenton (2003) 'Integrating the Least Developed Countries into the World Trading System: The Current Impact of EU Preferences under Everything But Arms', *World Bank Policy Research*, Working Paper 3018

b. ACP exporters also face market entry barriers including severe domestic competitiveness problems and supply-side constraints, such as a lack of infrastructure, investment and skilled labour.

8. The relative importance of market access and market entry barriers to ACP exports is critical to the EPA debate because, if the problems affecting ACP exports to the EU are related to market access then there is some value to improving preference arrangements. However, if market entry barriers are the primary reason for the failure of ACP countries to expand exports, then improved EU preferences are unlikely to have a significant effect on development in the ACP region. However, the relative importance of expanding these preferences will of course vary across countries and sectors.

9. The relative importance of preferences for agriculture products is greater than for non-agricultural ones. Whereas ACP countries are marginal suppliers of the EU in manufactures, they account for a significant one-eight of all EU imports of agricultural products[7]. This is due to the fact the Cotonou Agreement provides agricultural preferences that are commercially valuable on a number of Common Agriculture Policy (CAP) items for which trade policy is restrictive. In this sense, the value of preferences when they allow exporters to avoid agricultural protectionism that would apply to non-preferential countries (for example beef or sugar, horticulture and flowers.

10. Preferences for sugar are particularly valuable for Congo, Cote d'Ivoire, Madagascar, Malawi, Mauritius, Swaziland and Zimbabwe because they have country-quotas. Preferences for beef are important for Botswana, Namibia, Swaziland and Zimbabwe because they can comply with extra preference conditions related to compliance with foot and mouth disease standards.

11. The erosion of existing preferences is also an issue of concern for ACP countries (see Box 2.1 Preference Margins and their Erosion). As multilateral trade agreements progressively lower tariffs, the relative advantages of EU preferences for ACP countries will decline. Similarly, the value of ACP preferences will be diminished as the EU negotiates greater market access for other developing countries through bilateral and regional FTAs, such as those negotiated with Mexico, Chile, South Africa and Tunisia-Mediterranean[8]. Hence, regardless of whether an

[7] FAO (2006). The Agricultural Dimension of the ACP-EU Economic Partnership Agreements. Rome.

[8] Under the EU-Tunisia Mediterranean FTA, the EU provides duty-free and quota-free access to over 90% of exports from the Tunisia-Mediterranean countries. Exports from this region to the EU have increased by 14% and 19% in 2004 and 2005, while exports from Chile have grown annually by 30%. See Report from DG Trade of the European Commission to the European Parliament (2006) 'Preferential Trade in the EU – Making Trade Policy Work for Development:

EPA is concluded, ACP countries will see some degree of their preference margins eroded. Nonetheless, the perception amongst many stakeholders has been that if ACP countries do not sign an EPA, they will be 'left out in the cold' with less preferential access to the EU than their key competitors. The following sections of this Fact Sheet examine the extent to which this perception is founded.

Box 1: Preference Margins and their Erosion
A preference margin is the difference between the tariff applied to non-preference receiving countries and that applied to preference recipients. The tariff applied to non-preference receiving countries is known as the Most Favoured Nation (MFN) rate. For example, if exports of oranges from all countries into the EU had an MFN tariff of 10%, but the preference for ACP exporters was a 0% tariff, then the preference margin is 10%. Hence, if MFN tariffs on particular commodities are progressively reduced, then the value of being a preference receiving country is eroded. Preferences do not consist of only tariff reductions, but can also be granted through quotas and less restrictive Rules of Origin requirements.

II. Maintaining Preferences: What is the status quo?

12. The preferential trade regime that currently governs access to the EU market is complex. There are four arrangements under which ACP countries can export to the EU (see Table 2.1 The EU's Preferential Trading Regime). These include: the Most Favoured Nation (MFN) rate; the standard Generalised System of Preferences[9] (GSP-standard); the Cotonou Agreement; and the Everything But Arms Agreement (only available to LDCs). In addition, there is the 'GSP-plus' arrangement. ACP countries could potentially all be eligible for GSP-plus, but are not currently included. These arrangements are listed in Table 2.1 below, ranked from that the least to the most favourable conditions.

13. The value of the market access granted under a preferential agreement is assessed in terms of:

(a) the product coverage granted and the rules governing the use of preferences;
(b) the extent of tariff reduction granted – i.e. the preference margin ,or the size of increased quotas;

Report on the EU market access for developing countries and the potential for preference erosion 2003- 2005' (May 2006).
[9] In 1968, the United Nations Conference on Trade and Development (UNCTAD) recommended the creation of a 'Generalised System of Tariff Preferences' (GSP) under which industrialized countries would grant trade preferences to all developing countries. The system also allowed developed countries to establish individual GSP schemes.

(c) the extent to which a preference is actually utilized, i.e. the utilization rate.

Table 1: The EU's Preferential Trading Regime

Preference Agreement	Entry into Force	Eligible Countries	Market Access Provisions (coverage, duration, tariff treatment, binding nature etc.)
MFN	n/a	All WTO members	– Tariffs applied to all goods that enter the EU market not under preference scheme, Bound under WTO agreements (i.e. bound tariff rates are mandatory ceilings)
GSP	1971 (Reviewed January 2006)	All Developing Countries (178)	– Current GSP regime will last for ten years (2006 – 2015) but with a mid-term review. – Product Coverage: applies preferences vary depending on a product being categorised sensitive or non-sensitive. – Graduation Scheme: applies to groups of products from countries that are competitive on the EC market – Voluntary scheme, granted unilaterally – Provisions can be withdrawn whole or in part within 18 months under certain circumstances and subject to an investigation
GSP + (ACP not currently covered)	1 July 2005	Bolivia, Colombia, Ecuador, Peru and Venezuela, Costa Rica, El Salvador, Guatemala, Honduras, Nicaragua, and Panama, Moldova, Georgia, Mongolia and Sri Lanka.	– Offers substantially improved preferences compared to the Standard GSP, and covers a broader range of products. – Eligibility - countries that satisfy two criteria: a) vulnerability (related to smallness and diversification) b) commitment to human and labour rights, and environmental and governance principles – Granted unilaterally, can be withdrawn whole or in part within 18 months under certain circumstances and subject to an investigation.
Cotonou	2000	All ACP (77)	– Over 97% of ACP exports enter the EU markets duty free. – Commodity Protocols: preferential tariff quotas for bananas, sugar (Sugar Protocol and Special Preferential Sugar Scheme), beef and veal – Trade provisions of the Cotonou Agreement end on 31 December 2007, with the expiry of the WTO waiver – Article 96 of the Agreement sets out that in cases of violation of the requirements of respect of human rights, democratic principles and the rule of law, a consultation process will be used to resolve the situation. In the absence of an acceptable solution, appropriate measures may be taken, including suspension of the Agreement. – Article 98 also provides for dispute settlement procedures to deal with disputes arising from 'the interpretation or application' of Cotonou between the parties to the Agreement. These procedures have been hardly utilised.
EBA Initiative	Feb 2001	All LDCs (50 of which 39 ACP countries)	– Duty-free and quota-free access for all products, except Chapter 93 arms and munitions. – Transitional periods for the full liberalisation of bananas (2006) rice and sugar (2009). – Granted unilaterally, but runs for an unlimited period of time and is not subject to periodic review. However, a country no longer receives preferences if it graduates from LDC status.

Sources: compiled from EU website, http://ec.europa.eu/trade/index_en.htm; UNCTAD (2002) 'Generalised System of Preferences: Handbook on the Scheme of the European Community', UNCTAD Technical Cooperation Project on Market Access, Trade Laws and Preferences, December 2002; Article 96 and Article 98 of the Cotonou Agreement.

14. With the expiry of the WTO Waiver, it is only the market access provisions related to the Cotonou Agreement that will expire. The other preferential arrangements will remain in force.

III. HOW IMPORTANT IS COTONOU: WHAT WOULD BE THE LOSSES IF IT EXPIRES?

15. Of the 76 ACP countries with which the EU is negotiating an EPA, 37 are developing countries and 39 are least-developed countries (LDCs) (see Table 2.2 ACP countries: Developing and LDC).

Table 2: Development Status of ACP Countries negotiating an EPA

Developing Countries	Antigua and Barbuda, Bahamas, Barbados, Belize, Botswana, Cameroon, Cook Islands, Congo, Dominica, Dominican Republic, Micronesia, Fiji, Gabon, Ghana, Grenada, Guyana, Cote d'Ivoire, Jamaica, Kenya, Marshall Islands, Mauritius, Namibia, Nauru, Nigeria, Niue, Palau, Papua New Guinea, Seychelles, St. Lucia, St. Vincent, St. Kitts and Nevis, South Africa, Suriname, Swaziland, Tonga, Trinidad and Tobago, Zimbabwe.
Least-Developed Countries (LDC)	Angola, Benin, Burkina Faso, Burundi, Cape Verde, Central African Republic (CAR), Chad, Comoros, Democratic Republic of Congo (DRC), Djibouti, Equatorial Guinea, Eritrea, Ethiopia, Gambia, Guinea, Guinea-Bissau, Haiti, Kiribati, Lesotho, Liberia, Madagascar, Malawi, Mali, Mauritania, Mozambique, Niger, Rwanda, Samoa, Sao Tome and Principe, Senegal, Sierra Leone, Solomon Islands, Sudan, Tanzania, Togo, Tuvalu, Uganda, Vanuatu, Zambia.

Sources: compiled from the EU trade website, http://ec.europa.eu/trade/index_en.htm, and the UN-OHRLLS website, www.un.org/special-rep/ohrlls/ldc/list.htm

16. The impact of losing Cotonou preferences depends on the other options available to exporters. Since ACP countries differ in their development status, and hence eligibility for preferential schemes, the impact of losing Cotonou preferences will be different for LDCs and non-LDCs.

A. LDCs – the Value of Cotonou & Moving to EBA

17. All LDC ACP countries are eligible for the Everything But Arms (EBA Initiative). This provides duty-free and quota-free access to the EU for all products originating from LDC countries and is hence more favourable than Cotonou. Under Cotonou, a total of 919 tariff lines in sensitive sectors are excluded from

preferences[10]. At present, LDC ACP countries tend to utilize Cotonou more than they do the provisions of EBA, but this is largely due to the irrelevance of EBA whilst Cotonou remains in force[11].

18. However, LDC ACP exports to the EU could be significantly hurt by the loss of Cotonou and the switch to EBA in at least three ways:

1. The Loss of Cotonou's Commodity Protocols:

19. A highly significant exception, where EBA does not provide more favourable treatment than Cotonou, is the provisions relating to bananas, beef and veal, and sugar. These commodities are all covered by specific Protocols within the Cotonou Agreement, which grants specific tariff quotas and, in some cases, guaranteed prices for exports. Although, EBA provides for the full liberalisation of bananas (by 2006), rice and sugar (by 2009), these duty-free and quota-free provisions are not as valuable as the guaranteed prices provided under the Commodity Protocols. Within this, sugar is likely to be the commodity that faces the highest losses from the loss of Cotonou's Protocols. The LDC-ACP net exporters of sugar to the EU that will be subsequently affected include Burkina Faso, Ethiopia, Malawi, Sudan, Tanzania, Zambia and Mozambique[12].

20. The challenge for these countries is that negotiating an EPA is unlikely to result in equivalent treatment. The Commodity Protocols are already undergoing a reform process, which looks set to continue regardless of the EPA negotiations. (For further discussion see 3.2 Non-LDC ACP Countries – The Value of Cotonou).

2. EBA's more restrictive Rules of Origin:

21. If LDC-ACP countries switch from using Cotonou to EBA, their exports could be affected by EBA's restrictive rules of origin (see Box 2.2 Rules of Origin Explained)., which are more restrictive than those of Cotonou in several ways:

(a) *Cumulation*: Cumulation allows inputs from specified countries to be treated as originating materials from the country asking for the preferential access. Cotonou allows 'full cumulation', which means that an ACP export will

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[10] L. Hinkle et al (2005) 'Beyond Cotonou: Economic Partnership Agreements in Africa'. In: Trade, Doha, and Development: A window into the issues, R. Newfarmer (ed.) Washington DC: The World Bank, p. 275
[11] P. Brenton (2003) argues that the low utilisation rate of preferences under EBA reflects the fact that the vast majority of LDC-ACP exports already enter the EU duty-free under Cotonou. He argues this is partly due to EBA's rules of origin, which are more restrictive than under Cotonou.
[12] LMC International and Oxford Policy Management (2004) *Addressing the impact of preference erosion in sugar on developing countries*. September. London.

qualify for any processing that has been carried out in any country that is party to the agreement.[13] EBA only provides for 'bilateral cumulation' (i.e. between the EU and the recipient country).[14]

(b) *Minimum Processing Rules/Tolerance Rules*: Cotonou allows non-originating inputs to be used so long as their value does not exceed 15% of the ex-works price of the product. Under EBA the value must not exceed 10% of the ex-works price.

(c) *Fisheries*: The conditions pertaining to the vessels that catch fish are more liberal under Cotonou than EBA. For example, under EBA vessels must sail under the flag of the beneficiary country of the EU, whilst under Cotonou, vessels can sail under the flag of any ACP country or the EU.[15]

> **Box 2: Rules of Origin Explained**
> Rules of Origin define the condition that a product must satisfy in order to 'originate' from the exporting country, which is granted preferential access. The main justification for Rules of Origin is to prevent trade deflection, whereby products from non-participating countries are redirected through countries who are recipients of trade preferences, in order to avoid the payment of customs duties. However, current stringent and complex rules of origin regimes are seen by many stakeholders as a form of protectionism that has effectively restricted market access, and led to the under utilization of preferences.

22. The significance of these differences in rules of origin depends on the extent to which ACP exporters rely on other ACP countries for their manufacturing inputs, the extent of non-originating inputs currently used by ACP exporters, and the ownership of fishing vessels. These have yet to be studied.

3. The Adjustment Costs of Switching:

23. For LDC-ACP countries that are still exporting under Cotonou, there are likely to be some adjustments costs in switching to EBA. These costs are partly due to the different administrative procedures that govern the two preferential trade agreements. For example, EBA documentation is covered by (Form A), whereas for Cotonou it is the (EUR1) application.

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[13] Under Cotonou there is also the possibility for cumulation with South Africa, provided that the value added exceeds the value of material from South Africa.

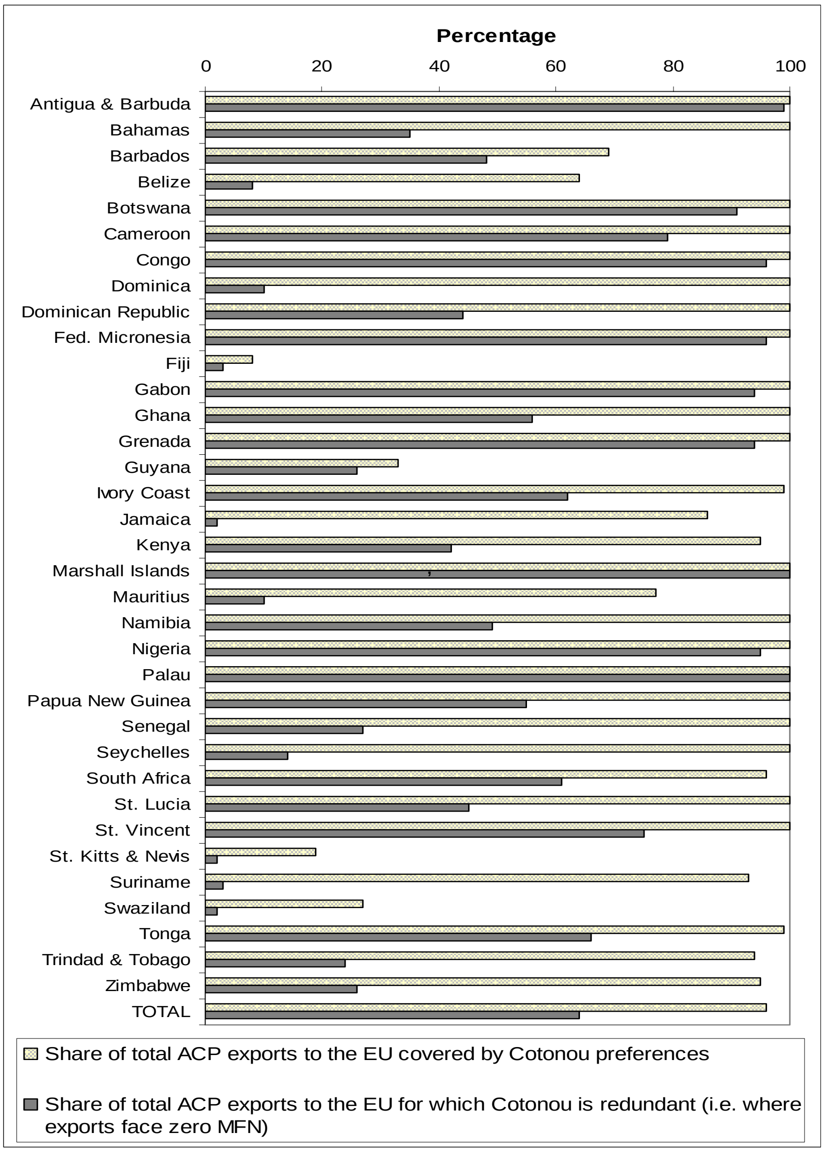
[14] The EU's GSP scheme provides for diagonal cumulation, which allows material from any preference recipient to be used in the processing of other preference recipients with the same region. This provision is only permitted for ASEAN, CACM, the Adean Community and SAARC, not ACP countries.

[15] P. Brenton (2003) p. 24.

B. Non-LDC ACP Countries – The Value of Cotonou

24. About 97% of all non-LDC ACP exports to the EU are eligible for preferences under Cotonou[16]. Though this figure is substantial, there is considerable variation between countries in the share of their exports that are covered under Cotonou (see Diagram 1). For example, only 8% of Fiji's total exports to the EU are covered under Cotonou, whereas in the case of Botswana all of its exports are covered[17]. However, in many cases ACP exporters can get equivalent access to the EU market through the GSP or MFN systems.

Diagram 1: Cotonou Product Coverage and Preference Margin



Source: data adapted from Manchin (2005)

1. The MFN System

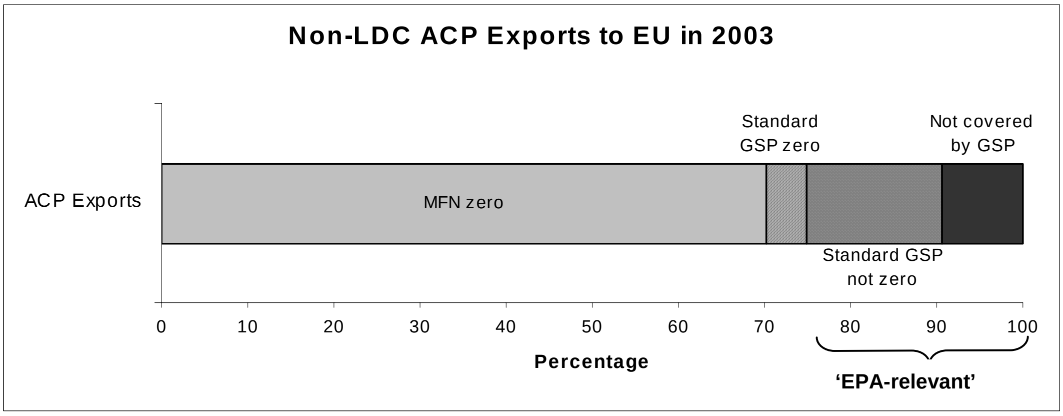
[16] M. Manchin (2005) estimates that 4% of exports from non-LDC ACP countries are excluded from preferences under Cotonou p. 1249
[17] M. Manchin (2005) p. 1248

25. Analysis of the MFN rates shows that many ACP exports are zero-rated under MFN and, hence, for these exports Cotonou provides no preference (see the darker shaded bar in Diagram 1). For several non-LDC ACP countries, Cotonou provides only limited preferential margins[18]. This is partly because exports of minerals and oil face zero MFN tariffs and these are the chief exports of Botswana (diamonds), Congo (oil) and Nigeria (oil). In contrast, Cotonou preferences are valuable for over 60% of exports from the Bahamas, Dominica, Jamaica, Mauritius, Senegal, Seychelles, Suriname, Trinidad and Tobago, and Zimbabwe. In Diagram 1 the share of exports from an ACP country where Cotonou preferences are of some value, is represented by difference between the lighter shaded bar and the darker shaded bar.

2. The GSP system

26. In addition to MFN rates, after the expiry of Cotonou, non-LDC ACP countries will still have preferential access to the EU market under the standard GSP. Diagram 2 below shows the percentage of non-LDC ACP exports to the EU that currently face zero duties under MFN and GSP.

Diagram 2: Non-LDC ACP Exports to the EU in 2003



Source: data from Stevens and Kennan (2005a). The diagram presents findings on 94% of the value of European imports from the ACP Group in 2003 (US$22.2billion of the US$23billion).
Note: Whereas, Stevens and Kennan term the 25% of exports not covered by MFN zero or GSP zero as 'GSP-relevant', this report uses the term 'EPA relevant'.

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[18] M. Manchin (2005) estimates that nearly 64% of total exports from non-LDC ACP countries to the EU entered under zero MFN tariffs. This figure is slightly lower than Stevens and Kennan who estimate that it is 70% of total exports see Stevens and Kennan (2005a) 'GSP Reform: a longer-term strategy (with special reference to the ACP)', Report Prepared for the Department for International Development (DFID), Institute of Development Studies (IDS) February 2005, p. 16.

27. Diagram 2 shows that nearly 75% of non-LDC ACP trade with the EU would not be affected by the expiry of Cotonou. This is because 70% of non-LDC ACP exports into the EU face MFN zero tariffs, and an additional 5% are accorded duty-free access under the standard GSP. Thus, it is the remaining 25% of exports, which would not be eligible for duty-free access under the current GSP system if Cotonou expired (labelled 'EPA-relevant'[19] in the Diagram). This is the amount of trade that constitute a concern.

28. Thus, although Cotonou could cover 96% of non-LDC ACP exports, in reality it accords a significant margin of preference for only 25% of non-LDC ACP exports to the EU.[20]

3. Commodity Protocols

29. The most valuable EU preferences have been those extended to a few traditional primary exports governed under specific Commodity Protocols within the Cotonou Agreements. These exports include Beef and Veal (Protocol 4), Bananas (Protocol 5), Sugar (Protocol 6). The preferences granted under these Protocols consist of a mixture of arrangements, such as duty-free access on certain tariff quotas and guaranteed prices. For example, under the Sugar protocol the EC annually buys a fixed quantity of sugar from ACP producers at its internal (i.e. EU) sugar price, which is higher than the world price for sugar. Under the Beef and Veal Protocol, the EC refunds 90% of tax normally paid on beef imports from several ACP countries. While under the Banana Protocol the EC currently provides duty-free entry for specific quotas of ACP bananas into the EU.

30. The Cotonou Agreement foresees the review of the ACP commodity protocols in the framework of the EPA negotiations: "*the parties reaffirm the importance of the commodity protocols, attached to Annex V of this Agreement. They agree on the need to review the commodity protocols in the context of the new trading arrangements, in particular as regards their compatibility with WTO rules, with a view to safeguarding the benefits derived therefrom*".

[19] For a list of products included in this GSP-relevant category see C. Stevens and J. Kennan (2005a) p.17

[20] Stevens & Kennan's Methodology aims at identifying the share of non-LDC ACP exports to the EU that would be affected by the expiry of Cotonou and the move to standard GSP should an EPA not be concluded. This is done by finding the range of products that ACP countries currently export, in other than insignificant amounts, to the EU and their treatment under GSP standard. The methodology Stevens and Kennan (2005) employ is to analyse EU import statistics from the ACP twice: once to pick up products that are relatively important to any ACP state (i.e. 5% or more of a country's total exports to the EU), and then a second time to identify any overlooked item whose export value to the EU is substantial (US$10million or more). Finally, the tariff applied to each of these export products under the standard GSP is examined.

31. The future of these Commodity Protocols is a major concern for ACP countries as it is unlikely that they will continue beyond the expiry of the WTO Waiver[21]. The impact of this will be significant as many ACP countries are highly dependent on exports of these commodities. Table 2.3 below shows the importance of the sugar and banana Protocols for select ACP countries. For example, in Guyana, the value of sugar preferences is equivalent to 9.3% of GDP. In 2003 the premium obtained by ACP beneficiaries (for both the Sugar Protocol and EBA Framework Agreement) was estimated at 476million euros[22].

Table 3: The Value of Sugar and Banana Protocols, Select Countries, 2000-2002

	Exports as a % of Total Merchandise Exports	Exports as a % of GDP	Value of Preference as a % of GDP	Sugar Sector Employment* (no. of employees)
Sugar				
Fiji	20	6.3	3.5	101,600
Guyana	20	14	9.3	33,100
Jamaica	4	0.9	0.7	51,500
Mauritius	6	5.7	4.6	51,600
St Kitts and Nevis*	N/a	28	N/a	9,400
Swaziland*	N/a	24	N/a	93,000
Bananas				
St. Lucia	65	4.3	0.71	
St. Vincent	38.6	4.6	0.94	
Dominica	26	4.7	0.71	

Source: FAO (2004) 'Small Island Developing States, Agricultural production and trade, preferences and policy', Commodities and Trade Technical Paper No. 7. Rome.
(*) Note: Data on St Kitts and Nevis and Swaziland, and on employment in the sugar sector employment from http://www.acpsugar.org/Facts%20and%20Figures.html. Employment figures for 2003.

4. Erosion of the Commodity Protocols: A real 'opportunity cost'?

32. It is questionable though to what extent the fear of losing these Protocols ought to be an incentive to negotiate an EPA. It appears that even if an EPA is concluded, ACP countries will stand to partially lose their current preference margins for these commodities due to preference erosion. As a matter of fact, the

[21] The rum protocol annexed to the Lomé Convention was not renewed under the Cotonou Agreement, and the treatment of bananas and sugar has already faced legal challenges under the WTO dispute settlement mechanism.
[22] H. Chaplin and A. Matthews (2006) Coping with the Fallout for Preference-receiving Countries form the EU Sugar-Reform', *The Estey Centre Journal of International Law and Trade policy*, 7 (1) p.18

erosion of these Commodity Protocols has already begun. The EC has offered to reform the sugar Common Market Organisation (CMO) through, among other things:

(a) a 39% reduction in the guide price of white sugar by 2007/8;
(b) a cut in the raw sugar price from 523.7euros per tonne to 319.5euros by 2009/10; and,
(c) a 42.6% reduction in the sugar beet price[23].

33. These changes will occur regardless of the EPA negotiations and are likely to be costly for ACP countries. The revenue loss on exports to the EU for sugar under the Sugar Protocol, even with the EBA Framework Agreement, is estimated at around 250million euros[24]. Countries that will suffer the highest absolute losses are those with the highest quotas, namely Mauritius (100.3million euros), Fiji (42.8million euros) and Guyana (40.8million euros)[25].

34. Further research is required to examine what will be the impact on the banana and veal protocols as a result of the EU's internal market reforms.

35. In addition, it is uncertain how these Commodity Protocols will be treated under an EPA. Further analysis is required to understand the extent to which an EPA will be able to maintain some degree of preference for these commodities. The future of these commodities will be especially important for non-LDC ACP countries because they will not be eligible for EBA, which provides LDC ACP countries with duty-free and quota-free access for bananas (by 2006) and sugar (by 2009).

IV. HOW MUCH MORE MARKET ACCESS WOULD EPAS PROVIDE?

36. Having examined the value of current preferential trade agreements, it is possible to identify what ACP countries might stand to gain from an EPA. These might include:

A. Minimal Improvements in Product Coverage

37. According to the EU offer to liberalise 100% of its trade with the ACP, what will this improved market access be worth? The above analysis has shown that substantial market access alternatives already exist for LDC countries in the form of EBAs. For non-LDC ACP countries, signing EPAs would maintain their current access to EU markets or increase it to include those products not covered by the

[23] H. Chaplin and A. Matthews (2006) p. 20
[24] *Ibid,* p. 20
[25] *Ibid,* p. 24

Cotonou Agreement (919 tariff lines in sensitive products)[26]. In sub-Saharan Africa it is estimated that this increased market access under an EPA will be worth 3-8% of the value of their current exports to the EU for Botswana, Namibia, Cameroon and Cote d'Ivoire[27]. Improved market access will be worth less than 1% of the value of current exports to the EU for Zimbabwe, Kenya, Swaziland, Mauritius, Seychelles, Ghana, Congo, Gabon, and Nigeria[28].

<u>B. Greater Certainty of Market Access</u>

38. If ACP countries negotiate an EPA, this will provide them with securer duty-free and quota-free market access to the EU. In contrast, the GSP scheme is subject to periodic review and withdrawal, which creates uncertainty for private investment. Although, EBA preferences last for as long as a country remains an LDC, successfully exporting countries can quickly graduate from LDC status and thus to the less favourable GSP scheme. As a result, the provision of more secure market access under an EPA might encourage greater investment into ACP economies, particularly in the export sector, as investors seek to take advantage of preferences that are more stable and predictable.

<u>C. Liberalisation of Rules of Origin</u>

39. Under an EPA, ACP countries may be able to negotiate a more favourable Rules of Origin framework for their exports into the EU. Historically, the demanding Rules of Origin under GSP and, to a lesser extent, the Cotonou Agreement, have hindered more dynamic export growth in ACP countries[29]. As a result, a more favourable and uniform criterion of 10% value added – as proposed by the UK's Commission for Africa – or a simple change-of-tariff-heading rule could increase exports for ACP countries[30]. Allowing global cumulation from all other developing countries, including between countries from different ACP EPA Groupings, could also provide greater export opportunities.

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[26] L. Hinkle and R. Newfarmer (2005) 'Risks and Rewards of Regional Trade Agreements in Africa: Economic Partnership Agreements (EPAs) between the EU and SSA', Development Economics Department, World Bank, Washington, D.C. p.19

[27] L. Hinkle and R. Newfarmer (2005) estimate the value of increased EPA market access by assuming that an EPA would have similar 'EBA access' provisions, that is, it will provide tariff-free and quota-free market access for everything. *Ibid*, p. 19

[28] *Ibid*, p. 19

[29] Restrictive rules of origin penalise producers by forcing them to rely on 'eligible' inputs, which often come at the cost of lower quality and higher prices. This cost often exceeds the benefits of the EU preference.

[30] L. Hinkle et al (2005) p. 276

D. Liberalisation of Aspects of Trade in Services

40. In case the ACP want to include negotiations of trade in services in their EPA, it potentially provide 'new preferences' to ACP countries in the services sector. In particular, the temporary migration of people (Mode 4) could be an important part of EPA service negotiations since the ACP region should have a comparative advantage in its supply as it is by definition labour intensive as a region[31]. It has been estimated that Africa would gain around US$14 billion from increased developed country quotas for both skilled and unskilled temporary workers[32]. Although the potential gains are large, it is unclear how Mode 4 could be incorporated into an EPA framework, and whether it would require the reciprocal liberalisation of services in ACP countries.

V. WHAT DO ACP COUNTRIES STAND TO LOSE IF THEY DO NOT SIGN AN EPA? THE ALTERNATIVES

41. In the event that ACP countries do not conclude an EPA with the EU, what are their alternatives?

42. We have seen that the most likely option for LDC-ACP countries would be to export to the EU under the EBA Initiative, which will continue to run regardless of whether an EPA is signed. The EBA Initiative would provide better coverage than Cotonou, but has more restrictive rules of origin and, unlike an EPA, would not provide binding market access.

43. Non-LDC ACP countries also have the option of using GSP or MFN systems, which provide zero tariffs for 75% of their exports to the EU. The remaining 25% of non-LDC ACP exports would not be covered by preferential access if an EPA is not concluded and these countries were forced to revert to the standard GSP scheme.

44. Although non-LDC members of the ACP group would suffer some losses if they had to rely on the other existing preferential schemes for access to the EU, *this eventuality is highly unlikely, even if an EPA is not signed*. The Cotonou Agreement commits the EU to 'assess the situation' of non-LDC ACP states that decide 'they are

[31] D. teVelde (2005) 'Temporary movement of natural persons in EU trade agreements: issues, existing provisions and options for EPA negotiations', Paper prepared for Second Meeting of the COMESA Technical Working Group of Services Specialists for the Regional Services Assessment. Mauritius, 11-15 July.

[32] A. Winters (2002) 'The Economic Implications of liberalising mode 4', Trade Paper prepared for the joint WTO-World Bank symposium on 'The movement of natural persons (mode 4) under the GATS'. WTO. Geneva. 11-12 April, quoted in ODI (2006) 'The Potential Effects of Economic Partnership Agreements: What Quantitative Models Say', June 2006.

not in a position' to enter EPAs in order 'to provide these countries with a new framework for trade which is *equivalent to their situation* and in conformity with WTO rules' (Article 37.6). This creates the clear obligation that no non-LDC ACP be worse off in terms of its market access to the EU if it does not sign an EPA.

45. There are a variety of options available, which would provide Cotonou equivalent market access treatment to the EU and do not entail signing a free trade agreement with the EU:

(a) Option 1: The creation of a special GSP-ACP tranche
(b) Option 2: The extension of 'GSP-plus' provisions
(c) Option 3: The extension of standard GSP provisions
(d) Option 4: The continuation of Cotonou under a new waiver

A. Option 1: Special GSP-ACP Tranche

46. A new tranche of GSP could be created exclusively for ACP countries, providing preferential access equivalent to Cotonou. This is unlikely to be politically feasible because it does not conform with the WTO Enabling Clause (under which the GSP was created), which states that a preferential access scheme must either apply to all developing countries, or all LDCs. A recent WTO Appellate Body ruled that it is possible to differentiate within GSP provided that such differentiation is related to 'widely recognised development, financial or trade needs'[33]. Under this ruling, a GSP-ACP tranche would not survive a WTO challenge because its differentiation (i.e. only for ACP countries) would be related to geographic and historical lines, rather than widely-recognised development needs.

B. Option 2: Extending GSP-Plus

47. The GSP-plus scheme provides 15 developing countries, mainly in Latin America, with preferential access to the EU. To be eligible for GSP-plus a country must first meet the requirement of 'vulnerability', which relates to measures of economic diversification and smallness (see Table 2.1 The EU's Preferential Trade Regime, above). GSP-plus scheme does not currently cover ACP countries because these countries already receive preferences under Cotonou, however, no ACP country would be a priori excluded from the scheme as they all meet the requirement of vulnerability[34]. Thus, if ACP countries ratify the relevant

[33] In 2002 India complained to the WTO that the EU's 'anti-narcotics' GSP arrangement contravened the EU's multilateral obligations. The WTO Appellate Body found in India's favour in April 2004 and subsequent arbitration requested the EU to amend its trade policy. WTO Document WT/DS246/AB/R 'European Communities – conditions for the granting of tariff preferences to developing countries', Report of the Appellate Body', 7 April 2004.
[34] Based on calculations from C. Stevens and J. Kennan (2005a)

international conventions on human rights and labour standards, which is the second criterion for eligibility, they could also be covered under GSP-plus.

48. For market access provisions under GSP-plus to become Cotonou equivalent, the product coverage of GSP-plus would have to be extended. According to Stevens and Kennan, there are approximately 28 products that fit into this category including fresh and frozen beef, sugar, fish, cut flowers, vegetables, citrus fruit, wheat, malt, palm oil, rum, skins (lamb, goat and sheep), aluminium and zinc[35].

49. A key advantage of Cotonou is that ACP countries are treated more favourably than some of their developing country competitors. Expanding the standard GSP or GSP+ would entail some erosion of preference margins (the more countries are extended the same preference to, the less valuable that preference becomes). Under Cotonou, the EU undertook to provide equivalent market access arrangements under Article 37.6, but did not agree to maintain the preference margins it accords ACP countries under Cotonou.

50. The extension of preferential access under an extended GSP-plus scheme would result in some preference erosion as the 15 non-ACP countries currently eligible for GSP-plus would also be granted Cotonou equivalent access. Preference erosion under an expanded GSP-plus would occur for four products; bananas, fresh table grapes, rum and tafia, and skins of sheep or lamb (see Table 2.4 below). With the exception of bananas, these products are of minimal economic significance to ACP countries. The methodology Stevens and Kennan use to identify the products for which there will be preference erosion is also described in Box 2.3 below.

Table 4: GSP-Plus: key areas and potential preference erosion

Product	No. ACP exporters	ACP export Value 2003, ($million)	Main Competitors
Bananas, fresh (excluding plantains)	14	547.9	Costa Rica Ecuador Colombia
Fresh table grapes	3	12	Chile South Africa (not eligible GSP+)
Rum and Tafia	9	22.8	Cuba
Skins of sheep or lambs	4	15.8	Syria
Sugar*			

Source: Stevens and Kennan (2005a)
* Sugar not included in Stevens and Kennan analysis.

[35] *Ibid*, pp. 20-21

51. There is also likely to be significant preference erosion for sugar, however this product is not listed because the approach of identifying the main sources of preference erosion (see Box 2.3 below) does not work with sugar. Although other developing countries produce sugar at lower prices than ACP countries (cost price normally being an indicator of competitiveness), the EU's high tariffs on sugar imports make it too costly to import sugar into the EU from producers which do not currently receive substantial preferences[36].

Box 4: Preference Erosion from extending the GSP scheme: Stevens & Kennan's Methodology. The aim is to assess the potential for preference erosion on certain products from extending the GSP scheme's provisions so that they become Cotonou equivalent. This can be done by identifying the competitor countries that would benefit from a favourable change in their access to the EU market as a result of the extension of a GSP scheme. Countries that do not fall into this category are: all LDCs as they receive duty-free access under EBA, any country that has a bilateral agreement with the EU that already provides duty-free access, and any country that is not eligible for standard GSP or GSP plus. Hence, competitors are defined as all non-LDC, non-ACP GSP beneficiaries that account for 10% or more of EU imports of the product in question, based on 2003 trade data.

C. Options 3: Extending Standard GSP

52. The Standard GSP could be expanded to ensure parity with market access under Cotonou. However, as all developing countries are eligible for the standard GSP, the competition from other non-ACP countries would be included and the extent of preference erosion would be much greater. In addition to the five products identified under an extended GSP-plus, other items that would face significant preference erosion from extending the standard GSP arrangement would include beef, oranges, rice, molasses, canned tuna, fresh beans, frozen hake and monkfish, prepared beans, preserved pineapples and pineapple juice, and cocoa paste[37].

53. Given that there is no reason why ACP countries would be excluded from GSP-plus (other than their failure to ratify and implement all of the required conventions), it is unlikely that non-LDC ACP countries would have to fall back on an extended standard GSP arrangement.

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[36] *Ibid*, p. 21
[37] *Ibid*, p. 26

D. Option 4: Maintain Cotonou with a new Waiver?

54. The debate about the market access gains and losses of an EPA (and its alternatives) is predicated on the belief that the EU will be unable to obtain another Waiver for the trade provisions of the Cotonou Agreement, after the current one expires at the end of 2007. This is likely to be the case given the increasing legal challenges EU-ACP preferences have faced. If the EU continued to provide preferences under Cotonou, but without seeking WTO-compatibility in the form of another Waiver, continued preferences would be uncertain and unpredictable as they could be challenged at any time. Moreover, continuing Cotonou without securing a new waiver might also be seen as undermining the multilateral trading system.

55. As the EU has legal obligations flowing from its Cotonou commitments with the ACP, the EC would need to invest its energy to obtain a positive decision on the extension of the Cotonou waiver, even if it is only for a limited number of years. This could allow ACP countries to negotiate the EPA under less pressure and hence, to better reflect their interests in the resulting outcomes.

CONCLUSION

Should ACP countries negotiate an EPA with the EU out of fear of losing their current preferences?

56. There are few defensive interests in terms of market access for ACP countries in the EPA negotiations. This is because the opportunity cost of not signing an EPA is limited given that LDCs will be covered by the EBA initiative, and that the EC will have to provide Cotonou-equivalent market access for non-LDC ACP countries, which is likely to take the form of an extended GSP-plus scheme.

57. However, if an EPA is not concluded and ACP countries revert to EBA or GSP-plus – as currently defined - their exports will be affected by the more restrictive rules of origin requirements of the GSP scheme (which covers both EBA and GSP-plus) and by preference erosion on a few key products for ACP countries.

58. The most valuable EU preferences that ACP countries stand to lose are the Commodity Protocols for bananas, beef and veal, and sugar. However, it is unclear whether this should be a stumbling block as these Protocols are already being eroded by the EU's internal market reforms and even under an EPA, it appears ACP countries stand to lose in part their current preferences for these commodities.

Should the further liberalisation of EU markets be seen as an incentive for ACP countries to negotiate an EPA?

59. An EPA will not substantially improve market access for ACP countries compared to the market access they currently enjoy. There are a few offensive interests for ACP countries in the negotiations. An EPA could provide market access improvements for ACP exports through:

(a) the liberalisation of tariff lines that are excluded under Cotonou. This would only have a marginal impact on non-LDC ACP countries because LDC ACP countries already receive duty-free and quota-free access to the EU for all products except arms under EBA;
(b) the liberalisation of rules of origin requirements;
(c) more predictable and secure market access;
(d) greater market access for services.

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