

**PREFERENTIAL TRADE IN THE EU – MAKING TRADE POLICY WORK
FOR DEVELOPMENT**

**Report on EU Market access for developing countries and
the potential for preference erosion.**

2003-2005

Report from DG Trade of the European Commission to the European Parliament

May 2006

1. The EU's preferential trade regimes

The EU's preferential regimes were described in detail in the previous report to the Parliament¹ so this report will give a more general overview, concentrating on any changes to these regimes in the time period covered. In general the picture that emerges from the analysis is of preferential regimes which are well utilised with significant increases seen in developing country exports to the EU, not only in energy products, which is to be expected, but also in manufactured goods.

There are two main preferential regimes providing access to the EU market which need to be considered :

1.1. The Cotonou Agreement – moving to a new regime with ACP partners....

The Cotonou Agreement provides a very high level of access to African Caribbean and Pacific (ACP) countries. Under the Cotonou trade provisions over 97% of ACP exports enter the EU markets duty free. This scheme has not changed in 2005, but will be replaced by the Economic Partnership Agreements (EPAs) being negotiated with a series of ACP regions. These need to come into force by 1st January 2008 when the current Cotonou trade provisions and the WTO waiver that covers them expire.

In terms of market access, the EU committed itself to granting ACP countries a regime not less favourable than Cotonou under EPAs. However, EPAs are more than just tariff agreements, they are expected to deal with issues which will boost ACP regional integration and trade performance. A joint EC-ACP review will be carried out this year to assess the progress made and help plan, region by region on how to meet the deadline for negotiations. That review will provide a much clearer picture on both the level of ambition and the state of play for each region.

1.2. The Generalised system of Preferences – a new system which favours sustainable development...

The GSP provides preferential access for all developing countries (178 in total) to the EU market. A new GSP scheme was adopted in 2005 and entered into force on 1st January 2006. The revised scheme is designed to be simpler, more transparent and more stable. The new GSP will remain unchanged until the end of 2008 hence providing stability and predictability for importers and exporters. The new scheme is also more generous as the product coverage of the GSP general arrangement has been extended to 300 additional products mostly in the agriculture and fishery sectors.

The new system seeks to maximise the benefits of the GSP for the more disadvantaged players on the market. It therefore focuses preferential access on countries most in need including small economies, small islands, landlocked countries and poorly diversified economies.

A clearer, simpler and fairer graduation mechanism has also been established. Graduation is applied to groups of products from countries that are competitive on the EC market and no longer need the GSP to boost their exports. The previous criteria (share of preferential imports, development index and export specialisation index) have been replaced with a single

¹ Opening the door to development – Developing country market access to EU markets 1999-2003. European Commission, DG Trade, 2005.

straightforward criterion: share of the Community market expressed as a share of exports from GSP countries. If groups of products in a given sector, from a given beneficiary account for more than 15% of EU imports from GSP countries, they are "graduated" i.e. they cease to benefit from preferential access. In the case of textiles and clothing the "graduation threshold" is set at 12.5%. Under the new regime, for example, China is graduated for 80% of its exports, although it remains in the GSP. As in the previous regime, Indian textiles does not benefit from the GSP preferential access because of the threshold, although its clothing exports continue to do so. In addition, graduation is no longer applied annually which allows economic operators to plan ahead.

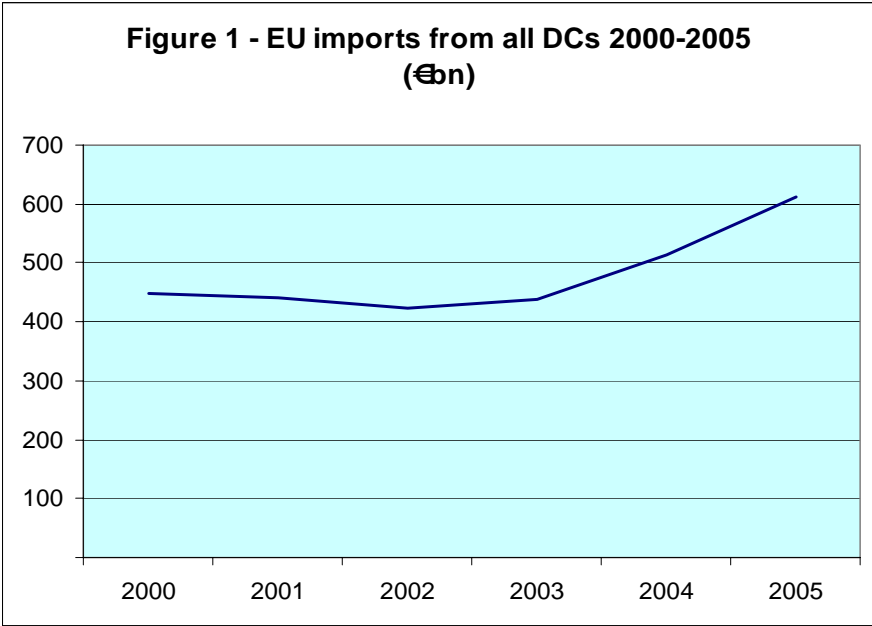
GSP Plus - The previous special arrangements in support of countries combating drugs, supporting labour rights and sustainable forest management have been replaced by a more generous and generic system called GSP plus. This incentive scheme will be targeted at especially vulnerable countries that have ratified and effectively implemented key international conventions related to sustainable development including environmental protection, human/labour rights and good governance. Currently it ensures duty free treatment in 91% of tariff lines and therefore represents an extremely generous level of access.

The GSP Plus incentive scheme entered into force on a provisional basis on 1 July 2005. The eligibility of countries placed in the GSP Plus incentive scheme was confirmed by an assessment of their effective implementation of relevant conventions. In December 2005, on the basis of this assessment, the Commission decided to grant GSP Plus benefits to the five Andean countries (Bolivia, Columbia, Ecuador, Peru & Venezuela), six Central America countries (Costa Rica, El Salvador, Guatemala, Honduras, Nicaragua & Panama), Moldova, Georgia, Mongolia and Sri Lanka.

The "Everything but Arms" arrangement which grants duty and quota free access for all imports except arms from least developed countries remains unchanged. This is the most generous access scheme for LDCs in the world. In 2006 bananas cease to be subject to any quota limitations for LDCs, which should bring further benefits.

2. Trends in EU imports from Developing countries

2.1. DC exports to the EU are showing healthy growth...



Overall, the time period covered (2003-2005) was a good one for DC exports to the EU. The following graphs will show the trends since 2000, to put them in historical perspective, but the commentary will mainly cover the last two years, which is the focus of this report. All figures presented are detailed in full in the

statistical annex attached.

The key message of the figures is that, after a few years of stagnation in the early years of the millennium (when trade in general stagnated), 2004 and 2005 saw strong growth with a 17% increase in DC exports in 2004 and a 19% increase in 2005. This overall strong performance, however, masks quite different trends for the different DC actors.

In order to differentiate between the performance of the different actors, the trends in imports from a series of different country groupings are presented below. These are the ACP grouping, the LDC grouping (both of which have substantially free access to the EU), the Mediterranean countries with which the EU has a strong evolving trade relationship and substantially free market access and, finally, the three developing countries with whom the EU has existing FTAs – Mexico, Chile and South Africa. The LDC, non-ACP grouping (Afghanistan, Bangladesh, Bhutan, Cambodia, Lao Dem Rep, Maldives, Nepal, Yemen) was also considered separately, both because they have a different export profile to other LDCs and because they have recourse to only one preferential arrangement (EBA).

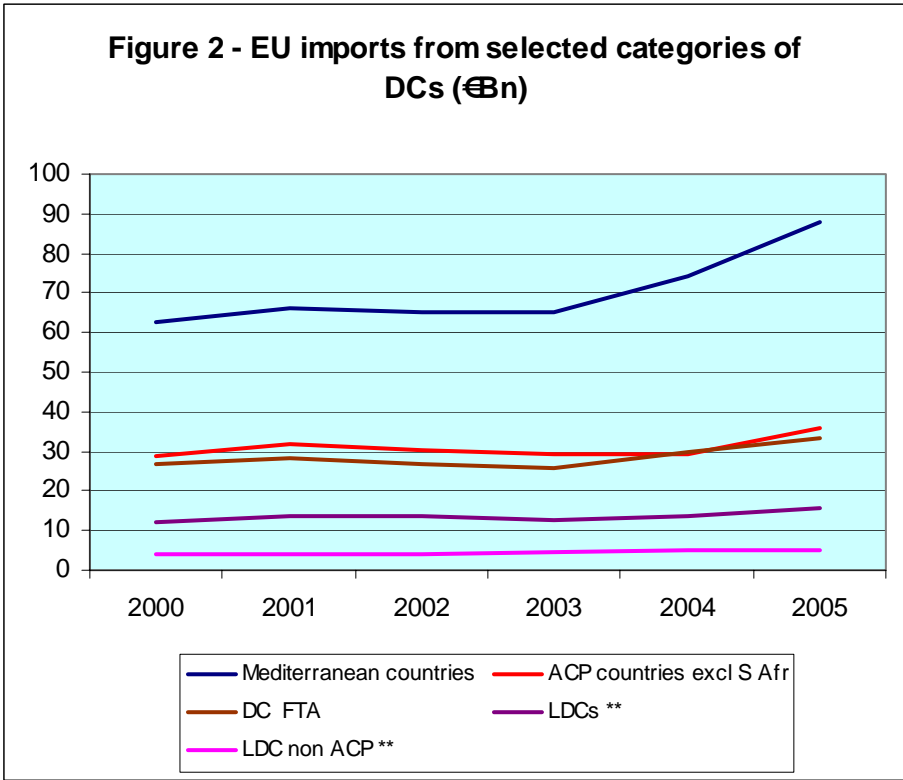


Figure 2 shows that the biggest increases have been seen in EU imports from the Mediterranean countries, which increased their exports by 14% and 19% respectively in 2004 and 2005 (slightly lower than DCs as a whole).

Imports from developing countries with which the EU has FTAs registered reasonable growth rates of 15% on annual average over the two years. The biggest increases

were seen for Chile with 30% annual average growth rates. Clearly the EU-Chile FTA which entered into force in 2003 is showing impacts on trade flows.

Imports from other developing countries (which means, in effect, those only subject to GSP rates of preferences) are not shown in the above graph. This is because the size of these flows (over half the total DC flows) would make trends in the other groupings difficult to read. For this grouping, exports to the EU increased by almost 50% in the two years covered. However, this is partly a reflection of the very high growth of Chinese exports which, alone, made up almost 40% of the exports of this group.

Others have seen less significant growth, with the LDC group, in particular, showing disappointing results, in spite of high levels of access. The LDC group saw an increase of

15% in 2005, but this represents over half the increase in exports over the whole period shown (29%). It is to be hoped that this represents a new dynamism in LDC exports after several years of mediocre performance. LDCs which are not in the ACP grouping saw their exports stagnate in 2005. As we will see when we look at sectoral trade, this is largely due to the fall in exports in the textiles sector due to the removal of the quota system.

The Everything But Arms regime giving full and free access to the EU market for LDCs was implemented in 2001. The graph shows that, overall, the new regime did not increase LDC exports significantly. Partly this was due to a rather un-dynamic EU import market at the time (most DCs saw stagnant export growth during this period). It is also due to the fact that LDCs already had very high levels of access to the EU even before EBA. Overall figures can be deceiving, however. In order to better understand the impacts of the initiative, the Commission sponsored a study in of the impacts of EBA in the first two years of its operation, which looked at changes in trade at tariff line level².

The study found that EBA improved access to the EU market in some 1224 products (hereinafter “EBA products”) for the non-ACP LDCs and in 1024 products for the ACP LDCs³ mainly in agricultural and food-processing products. This corresponds to over 10% of all dutiable tariff lines. The average increase in preferential margin was more than 30%.

Following the introduction of EBA, the volume of LDC exports of EBA products to the EU had increased by more than 100% by 2003, while the volume of such exports to the EU in the years preceding the initiative had fallen by 15%. The relative increase in exports of EBA products to the EU was greater for the Asian LDCs (174%) compared to the African LDCs (99%). Exports of a few products (tomatoes, garlic, vegetables, grain, cane sugar, cane molasses and oilcake) accounted for about 90% of all exports of EBA products. Sugar and vegetables are the most important products in value terms.

The main beneficiaries of the EBA in absolute terms in the first two years were sugar exporters in Malawi, Zambia, Tanzania, Ethiopia and Sudan, the value of whose exports amounted to about half of all exports of EBA products in 2003 (\$87 million). It is noteworthy that EBA also seems to have created new export markets. Burkina Faso, Ethiopia, Togo and Nepal exported few if any EBA products before the implementation of the initiative, but managed to claim close to 15% of total LDC EBA exports to the EU in 2003. An additional eight LDCs have also started to export EBA products to the EU since 2000.

2.2. Energy and manufacturing are the key drivers of export growth...

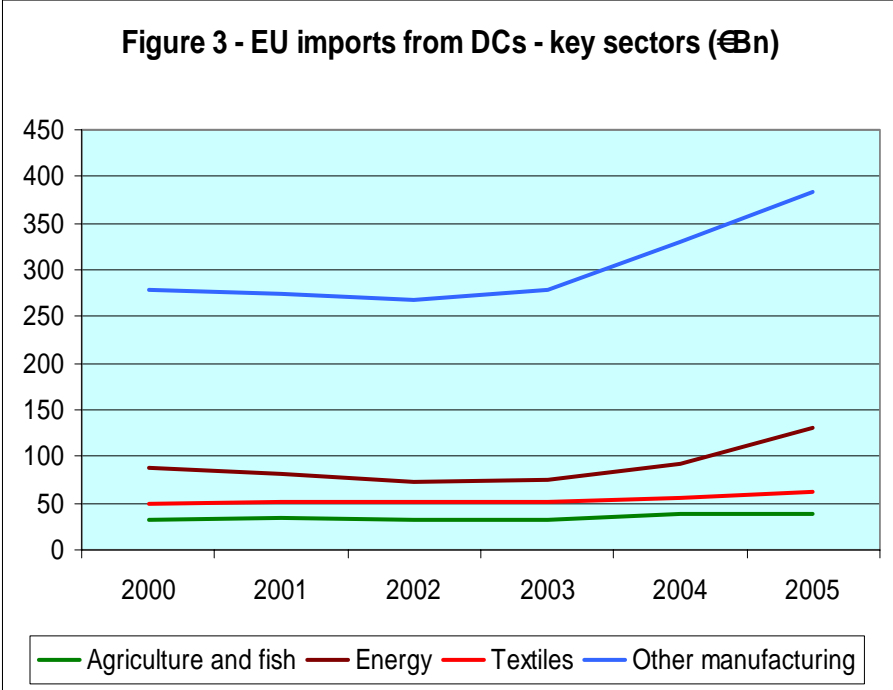
Trade performance differs between the different sectors. In order to better understand which sectors are driving the changes in trade flow we have disaggregated imports into the key sectors of agriculture and fish, energy, textiles and other manufacturing. As we see from the graph the key changes come from ‘other manufacturing’ and ‘energy’. The latter, which showed annual average increases of 36% over the last two years, is clearly related to changes in energy prices. Although this represents an increase in income for the countries concerned, it does not necessarily represent an increase in production.

The increase in ‘other manufacturing’ exports, however, is more significant in terms of likely developmental impacts. The general manufacturing sector has witnessed an annual average increase of over 18% per year in the last two years, representing more than €100bn in

² Gallezot and Bureau (2005) “The Trade Effects of the EU's Everything but Arms Initiative”. Report to the European Commission DG Trade.

³ At the 10-digit level of the Combined Nomenclature.

increased imports to the EU from DCs. This is likely to have significant impacts in terms of employment and wealth creation. The other two sectors show in the graph registered reasonable average annual increases of 9% for agriculture and 10% for textiles. Overall, therefore, exports from DCs grew in all sectors, however the motors for growth were ‘energy’ and ‘other manufacturing’. Although in percentage terms it was the energy sector which saw the largest gains, the biggest absolute gains were in ‘other manufacturing’.



If we look in more detail at the trends in sectoral trade within the different groups of developing countries there are a few points of note. In **agriculture** there was a sudden doubling of imports from GSP DCs in 2004, which largely responsible for a 20% increase in agricultural imports overall, although this increase was not sustained and agricultural imports

from DCs stayed static in 2005, while GSP DCs imports fell. In 2005 they were 50% higher than in 2003. Chile and the Med countries registered strong growth in this sector of almost 13% and 19% annual average.

Fish imports from most sources were fairly undynamic (general increase of less than 5% annually in 2004/5 for DCs as a group). However for Chile there was an annual average growth of 28%. The ACP group saw a slight fall in exports which averaged 1.6% annually.

Energy imports witnessed strong growth, largely due to increased prices. Imports from almost all DC groups increased. The biggest percentage increases are seen in the LDC groups. Imports from non-ACP LDCS almost tripled in 2005 compared to 2004, but this was from a low base after several years of stagnating exports⁴. LDCs as a group, however registered strong growth in 2005, bringing its annual average growth over the two years to 60%.

In **textiles**, we see a rather varied picture, in line with a major restructuring of supply following the abolition of quotas. While DCs as a whole gained, the ACP lost over the two years (-9% annual average falls), as did South Africa (-7%) and Chile (-22%). The vast majority of export reductions happened in 2005. For LDCs, increases in almost 20% in 2004 were followed by a fall of 5% in 2005. Given that textiles represented more than a third of LDC exports to the EU in 2004, such losses are significant.

The biggest gains from textile quota abolition went to China and India, both of whom increased their exports significantly in 2005 (42% and 18% respectively). Most other DC

⁴ These exports are almost entirely from Yemen, whose exports fluctuate extensively.

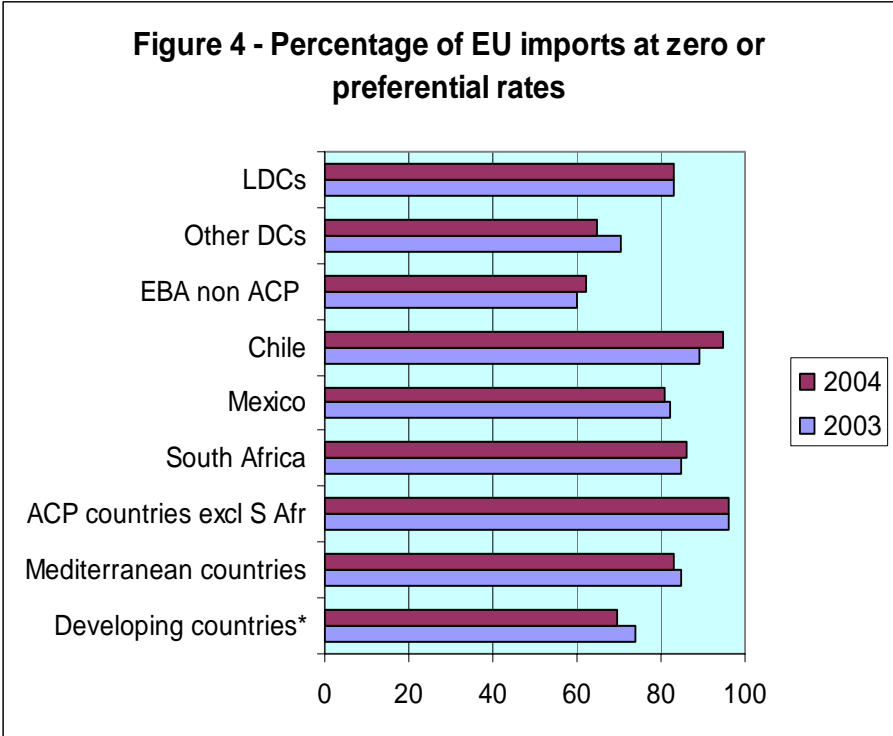
suppliers lost out, especially smaller more marginal players. Analysis by DG Trade indicates that the re-imposition of quota restrictions on Chinese exports in the middle of 2005 had a positive effect on exports from most DC suppliers, mitigating the negative effects on certain suppliers and accentuating the positive impacts on those who gained⁵.

In the **other manufacturing** category, big increases were seen for Chile (38% average annual increases over the two years), the Mediterranean countries (25%) and Mexico (20%). Non-ACP LDCs registered poor growth in this sector (2%), while South Africa and LDCs as a whole registered average increases of 5% annually. Clearly these latter figures are concerning. The poorest of the EU’s partners do not seem to be moving out of their historical dependence on basic commodities, in spite of high levels of access.

3. Preferential trade in the EU

As outlined above, imports to the EU are subject to several different preferential regimes. Part of the reason for the dynamism in exports from key developing country suppliers like the Euro-Med and Chile is due to the special access which these agreements provide. However the coverage of preferences varies between agreements. The extent to which preferential access is actually afforded to our trading partners depends on the structure of their exports, as well as the depth of the preferences in the particular agreement.

3.1. Preferences are exploited and do ensure high levels of market access to the EU...



In the past the EU has not been in a position to provide a comprehensive analysis of the overall utilisation rates of its various preferential regimes because of difficulties with data collection and standardisation. Today we have a new database from Eurostat which allows us to establish actual preferential trade flows with a higher level of certainty. This confirms that, contrary to the

frequent criticisms of the regimes from the press and NGOs, for most imports from the poorest regions, the EU provides very high levels of access.

⁵ Almost without exception, the falls in exports for DCs in the first six months of 2005 were significantly higher than for the full year. In the case of Vietnam, for example, a loss of 11% in the first six months turned into a gain of 5.6% in the full year.

Figure 4 shows the extent to which trade flows from different preferential sources are subject to preferences or zero duty (either MFN zero, or preferential zero access). Overall there has been a very slight fall in the level of preferential access, but this has not affected the poorest recipients – LDCs and ACP – whose access levels are stable. The fall is likely to partly reflect increased imports from China which are often not preferential because of graduation.

We see that the ACP registers almost all exports as duty free or preferential trade, while Chile also has above 90% of their exports to the EU entering at zero or preferential rates. Mexico, South Africa and the Mediterranean have equivalent figures of above 80%. The figures for LDCs are rather lower than would be expected from their very high levels of access, at 80%. This result, however, is largely due to the low figures of utilisation for non-ACP LDCs, which in turn is largely due to low utilisation rates in the textile sector. As exports in this sector from non-ACP LDCs were a third of total LDC exports in 2004 (and the majority of exports from the former), the utilisation rates registered there are significant.

3.2. Key problems with preference use are in textiles and clothing...

Looking in more detail at exports in the textiles and clothing sector, it quickly becomes clear that the main sector where difficulties are experienced is HS sector 62. This is the sector representing clothing made of woven fabric. Here there is clearly an issue with preference use as rates are very low. For example for Bangladesh in 2004 only 25% of goods in this tariff line category entered at zero preferential rates, compared to 81% in the knitted garments category – HS 61. This is a sector which represented just over €2.5bn in LDC exports to the EU in 2004, just less than 20% of all LDC exports.

It is difficult to surmise on the basis of statistics alone the reasons behind these differences, however it is notable than studies of preference use in the US find similar trends⁶. It seems likely that rules of origin could be a key reason behind low utilisation rates, as the manufacturing process for knitwear tends to be more conducive to double transformation than for woven clothing. In this context the above data leads to two key conclusions:

- Overall there are very high rates of utilisation of EU preferential schemes. Therefore for the majority of developing country suppliers and products, rules of origin are not a barrier to qualification for preferences.
- In the specific case of woven clothing there does seem to be a very low level of utilisation of preferences which, given the nature of the manufacturing process in this sector, seems likely to be linked to rules of origin. Thus, in as much as rules of origin are an issue for LDCs, they are limited to a specific sector, which represents 20% of their total trade.

For clothing made of woven fabric, the current criteria under preferential rules of origin require that two processing stages are undertaken in the country eligible to benefit from the tariff preference, i.e. the weaving of the fabric and the making up of the clothing (so called ‘double transformation’). Many developing countries (including Bangladesh) are manufacturing garments, but very few of them are also producing the woven fabrics. Weaving is very capital-intensive, and only certain developing countries (e.g. China, India, Pakistan) have competitive textile industries to provide such backward linkages.

⁶ Ozden and Brenton (2005) Trade preferences for apparel and the role of rules of origin – The case of Africa. Paper presented at WTO seminar on preference erosion, Geneva, 12-13 June 2005.

A possible solution to this problem might be the promotion of regional groupings (Euro Med, ASEAN, EPAs, SAARC, etc) within the EU's preferential regime. Within these areas, the rules of origin could be relaxed with a view to allow broader sourcing within the region for countries with no domestic textile industry (known as regional cumulation), thus allowing them to continue to benefit from tariff preferences.

The EU's own preferential rules of origin are currently under review and the Commission has proposed to move to a value added criteria for assessing origin and to a more simplified set of rules. Given the potential importance to developing countries, the Commission is in the process of assessing the impact of proposed changes to the rules of origin on the textiles sector, as well as agricultural, processed agricultural and fisheries products. The specific aim of this impact study is to assess the consequences of a shift to a value-added method for determining origin on the developing countries. The key question addressed is whether the value-added method contributes to simplification and allows developing countries to benefit more broadly. The study will feed into a wider impact assessment of the Commission proposals, including effects within the EU, as well as procedural aspects.

4. Preferential trade and the multilateral system

The EU's preferential trade flows take place in a wider political context. In particular unilateral preferences exist in a global trading system which is progressively moving towards liberalisation, especially on just those markets where preferences are most valuable – the industrialised country markets, particularly the EU. This means that, over time, developing countries will be less able to exploit their preferential access to the EU market as it will provide progressively less of an advantage on the market.

This issue has been the cause of some concern in the European Parliament. In Mr Moreno Sanchez' report⁷ presented in April 2005, paragraph 12, there was a specific call for further work on this issue:

Calls on the Commission to take due account of the erosive effects in relation to preferential margins of the DDA on the Cotonou Agreement and the GSP and other commercial preference systems, draw up a special report investigating the impact of the Doha Round on the Cotonou Agreement and the GSP, and consider what measures should be taken to guarantee the effectiveness of the preferences granted by the EU to developing countries, and especially to the poorest;

This section of the current report is in response to this request.

4.1. Preference Erosion – an issue of growing political importance...

The objective of the EU's preferential access programmes is to provide developing countries with a temporary advantage on the market to help them to compete. However, as each round of trade talks reduces MFN tariffs, so it reduces the advantages of preference holders. This issue – preference erosion- has become particularly problematic in the current round of trade talks. Why this should be the case is not immediately obvious, as the issue is not new - it is in the nature of trade liberalisation to erode previous preferential access. It is probably related to the increasing number of developing countries in WTO and the relatively low level of tariffs in general, which makes the possibility of further cuts rendering tariffs insignificant more likely. The emergence of China as a formidable exporter on world markets, and its accession

⁷ The assessment of the Doha Round following the WTO agreement on 1 August 2004

to the WTO, have also increased fears that in the absence of preferential access many DCs will be unable to compete. Finally the more extensive involvement of agricultural trade in this round is of particular concern to DCs who perceive themselves to be very dependent on preferences in this sector.

DCs have become increasingly active in WTO on this issue. It has held up negotiations several times. Clearly there is a need to address the issue, but first there needs to be a clear understanding of the extent of the problem.

4.2. Preference erosion is only a small part of the DDA story...

It is important to point out at the outset that most DCs have more to gain than lose from an ambitious round. The losses on developed markets will be more than offset by new market access elsewhere, especially if the larger developing countries agree to open their markets. This compensatory effect is not just theoretical. There was much concern about the impact of the recent removal of quotas on the Bangladeshi textiles sector⁸ and exports to the EU did, indeed, reduce by 5%. However their exports to the previously more heavily restricted US market increased by 19%⁹ and Bangladesh's aggregate exports rose.

In addition, much of the rhetoric on preference erosion ignores the reality of the current trading regime. Far from being a fortress with a few preferential back doors, the EU's tariff structure is very open in many sectors. The majority of DC exports to the EU, 57% in 2004, already enter at zero duty on an MFN basis. The figure for ACP exports is almost 70%. Thus for many DC exports, preference erosion is simply not an issue as there are no preferences to erode. This situation is not accidental. The EU has deliberately lowered and eliminated its tariffs and tariff peaks in products in which developing countries specialise, such as tropical products and raw materials. In those sectors where trade remains preferential developing countries need to adapt to a changing reality, but these changes will not happen overnight and will have strong impacts in only a few countries sectors.

4.3. Studies find that the impact is limited and concentrated in a few countries and sectors...

This problem has given rise to several studies in recent years. Estimated effects depend on whether models take into account the positive impacts of broader liberalisation. Most studies use either general equilibrium (CGE) models or work in partial equilibrium. So called CGE models estimate the welfare and production effects of trade liberalisation.¹⁰ Such models contain a network of linkages between industries and countries and take into account that a change in one part of the (world) economic system will affect other parts. Losses in a country's export sector may thus be compensated by gains in other sectors of the domestic economy or in other countries/regions under study. Partial equilibrium studies are easier to undertake, but they ignore such links, although they may be key to the overall impacts. Consequently, the former studies generally show both the impact of preference erosion and the overall positive effects of trade liberalisation, while the latter focus on the negative effects of trade liberalisation related to preference erosion.

⁸ Mlachila, M and Yang, Y (2004) The end of textiles quotas: A case study of the impact on Bangladesh, IMF, Washington.

⁹ see <http://otexa.ita.doc.gov/>

¹⁰ Welfare is a summary of the change in utility for a particular household and is expressed as the difference between nominal household income and an expenditure price index for the household.

Regardless of the methodology used, research indicates that fears of preference erosion are exaggerated. Table 1 in annex summarises the potential effects of preference erosion from a number of relatively recent and thorough studies on the issue. The results emanate from a variety of underlying assumptions and different methodologies focussing on different countries/regions. It is therefore difficult to compare the results. Nevertheless, the overall impression from these studies is that:

- Most developing countries have much more to gain from multilateral liberalisation than they lose from preference erosion.
- Preference erosion is likely to affect only certain countries and impacts will be fairly small in the aggregate.
- Nevertheless some countries will be negatively affected. These tend to be small and/or poor countries, often ACP and heavily dependent on a market which has been heavily distorted, like sugar or textiles.

The first three columns in annex display the result of CGE models. Francois et al (2005) assume that preferences are fully eroded which leads to a loss for African and Asian least developed countries (LDCs) which amounts to about \$200 million, while the group 'Other Low Income countries' gains about ten times as much. The IMF (2005) assume various cuts by both developed and developing countries (but not by LDCs) in the agricultural and non-agricultural sectors and finds that developing countries as a group would gain \$16 billion or 0.16% of their real income. The only region/sub-region to lose is 'Rest of SSA', whose loss is estimated at \$100 million or 0.02% of real income. Finally, the OECD (2005) conclude that a simultaneous 50% cut in ad-valorem equivalent measures of protection by the QUAD (EU, US, Canada and Japan) and Australia would lead to losses for only six developing countries plus the region/sub-region of 'Rest of SSA', while everybody else gains.

Even those studies that do not take the broader impacts of liberalisation into account show limited impacts. The partial equilibrium studies find that only a handful of countries risk losing more than 5% of their exports due to preference erosion. WTO (2005) is the only study that takes into account the important factor that competitors of the main preference beneficiaries normally do not export under MFN duties but rather under another preference schemes or free trade agreements. This study concludes that the loss of preference value in NAMA from Quad and Australian markets for LDCs would amount to \$170m against a corresponding gain for developing countries as a whole of \$2bn or 0.2% of exports¹¹

A subsequent study on agricultural products using the same methodology found that both LDCs and DCs experience a net gain in preference value of \$10.4m and \$258m respectively, although net gains conceal some losses. The smaller numbers than those found in NAMA reflect the relative importance of the two sectors, with agricultural imports in the Quad representing only \$57bn compared to \$892bn imports in non-agriculture¹². These figures represent the 'value' of preferences, not actual exports and thus can be rather confusing. Perhaps the most illuminating figures from the WTO studies are the sectoral breakdowns. This shows that in agriculture 90% of the value of preferences is made up of sugar and bananas, whereas in NAMA 90% is clothing and textiles. The highly specific nature of the

¹¹ Based on tariff reductions using the Swiss formula with a coefficient equal to ten in non-agricultural sectors.

¹² This latter figure includes Australia, but the small size of this market means the figures are fairly comparable.

problem was one of the main messages to emerge from a recent seminar in WTO where these papers were discussed¹³.

An initial analysis by the Commission on the impact of erosion of preferences on the EU market confirms that the problem is limited, although it is important for certain countries. This analysis indicates that the number of WTO developing country members for whom preferential exports to the EU are significant is rather low and that preference erosion is only an issue for these countries in the following sectors: sugar, bananas, vegetables, clothing, cut flowers and fish. The problem is that although the number of countries is small, they are often very poor or vulnerable ACP countries – with limited potential for diversification into new products.

The effects of preference erosion are highest for the ACP countries because of their particular vulnerability, isolation from the global trading systems and historical reliance on trade with the EU. The small volumes of ACP trade in comparison with the rest of the developing world makes it easy to overlook the local impact of preference erosion. It is in recognition of these unique circumstances that the EU and ACP agreed to develop Economic Partnership Agreements that cover both trade and development aspects and help to counteract the effects of preference erosion.

4.4. Potential solutions include both trade and non-trade measures...

In terms of trade policy solutions to the problem of preference erosion there are several potential actions which could mitigate the problem. First and foremost, multilateral liberalisation is key to ensuring that preference erosion is offset. Several studies show that if only the EU undertakes MFN liberalisation, quite a few developing countries lose. However, these losses are in most cases cancelled out and indeed transformed into gains when (i) liberalisation by other industrialised countries are brought into the picture, and (ii) liberalisation by developing countries themselves are included in the scenarios. This is why a balanced outcome of the DDA is so vital. Without movement on all sides there will not be adequate potential to balance losses on one market with gains elsewhere and preference erosion has much more potential to cause major development problems.

In addition, providing broader preferential market access helps to ensure that the poorest spread their exports across a wider range of products and markets, thus reducing their vulnerability. In this context, the recent commitment in Hong Kong for other key developed and developing country markets to follow the EU's lead and move towards duty free and quota free access for LDCs for at least 97% of tariff lines is an important step forward. It needs to be complemented by an agreement on a target date for 100% coverage of duty and quota free access for LDCs. Reforms of preferential rules of origin, aimed at simplifying the system and making it more development friendly, should also contribute to increasing preferential trade from DCs.

Nevertheless there are countries whose export and industrial structures are such that they are likely to suffer negative effects from preference erosion, even in a context of new market opportunities elsewhere. For them it has been suggested that one solution would be to roll liberalisation out more slowly in the sectors of most concern. The EU is open to considering this approach, if consensus can be achieved in WTO. The difficulty is that there are many countries which perceive themselves to suffer as a result of the trade diversion created by

¹³ Seminar on preference erosion in the context of DDA negotiations, WTO Geneva, 3 April 2006

preferences. They will be unwilling to easily accept such a system, which they see as further impeding their potential for trade growth.

Whether liberalisation is phased in or implemented quickly, aid and technical assistance should be forthcoming for those countries which will suffer as a result. Although the overall impact of preference erosion will be limited, the countries/regions that will lose out will need special measures to ensure that, in the medium term, their economies develop and are re-oriented to sectors in which their comparative advantages lie. This should enable them to exploit the new opportunities which the Doha Development Agenda will offer and ensure that they too gain from trade expansion. This non-trade element of support for DCs is less controversial than any specific trade measures. Difficulties with preference erosion will need to be taken into account in the distribution of aid for trade by the EU, although of course aid for trade goes much further than just addressing preference erosion.

In the specific ACP context, the EU is currently negotiating Economic Partnership Agreements precisely to take account of these issues and bring trade and non-trade solutions to bear. The EU and ACP agreed on the need for such wide ranging trade and development partnerships to build on our long trading history and experience. This involves moving from the simple offering of preferential access to a comprehensive pro-development approach to help the ACP integrate into the global economy, build regional markets and benefit from changing trade rules. Furthermore, the EU has already tackled the issue of preference erosion connected with sugar reform head on, allocating resources to help ACP sugar producing countries adjust to reform between 2006 and 2013 that are similar in magnitude to their predicted losses.

5. Aid for Trade – support for developing countries to address supply side constraints...

For many, access to developed markets is already high, but exports have often not expanded. We see this clearly in the EU market where our poorest partners, who have the highest levels of access are witnessing below average trade growth. Thus indications are that the problem is not related to market access, but to exploiting that access. Addressing supply side constraints is a key element in encouraging greater involvement in trade. The EU is a key actor in supplying 'aid for trade' and is increasing its commitments in this key area in recent years.

During the Hong Kong Ministerial meeting, the European Union announced that it would raise Aid for Trade spending to more than €2 billion a year from 2010. The European Commission announced at the G8 meeting in Gleneagles in July 2005 that it would spend €1 billion a year on Trade Related Assistance from 2007. European Member States have indicated that they will strive to ensure that their collective spending matches that figure by 2010. These funds do not include the money the European Union provides for infrastructure projects in Africa such as road building and energy and water which is currently more than 800 million euros a year.

A WTO task force on Aid for Trade was launched at Hong Kong. The EU is actively contributing to this work. The main objective of the EU is to ensure that an Aid for Trade package will be delivered as a complement to the negotiations which will allow all participants to take advantage of new opportunities which will be created by the DDA and to expand on existing ones.

The EU can provide support to DCs to develop their infrastructure and address problems with their supply side. However it cannot alone address all of their needs. The private sector will

inevitably need to cover some of their needs. In this context DCs can sometimes be their own worst enemies in terms of encouraging development. There is a need for appropriate legislation, particularly on property rights, to encourage investment, both domestic and international. There is also a need for proper enforcement and action to address corruption, which is a key problem in many DCs. Without a transparent and effective legal system, investment will continue to remain sub-optimal.

6. Future issues in market access.

The EU has already done a lot to secure access to its markets for developing countries, particularly the poorest amongst them. This report shows that these efforts are bearing fruit and that DCs are expanding their exports to the EU, although progress varies across regions and sectors. However the EU only represents 18% of world trade. The US represents another 17% and China, already over 8%. Efforts by the EU alone will not be adequate to enable developing countries to trade themselves out of poverty.

6.1. EBA is a start but alone it isn't enough...

The EU's efforts to support trade in the poorest countries need to be re-enforced by efforts on other markets. The agreement in Hong Kong for developed countries to provide duty free and quota free access to LDCs is an important step forward and one for which the EU actively campaigned. It is disappointing that the final agreement included a clause to limit this access to 97% of tariff lines, as this provides ample potential for lingering protectionism. Vigilance will be required to ensure the implementation of the spirit as well as the letter of the agreement.

In a broader context although market access to developed country markets is important, the most dynamic markets are not in the EU and other OECD, but emerging economies. Better access for the poorest countries to these markets could make a significant contribution to their development – not least because they are often more geographically proximate and more likely to have similar consumer preferences. These countries should also open their markets to the poorest in support of their development, as outlined in the Hong Kong agreement which stated that those DCs 'in a position to do so' should also provide tariff and quota free access. Action on this objective would be an important step forward, as only co-ordinated global action will prevent the continued marginalisation of the most vulnerable.

7. Conclusion

Overall this report provides a rather positive picture of developing country trade with the EU. Exports are expanding in all sectors and in all regions, although some are clearly benefiting more than others. In the DDA context this shows that accusations of protectionism against the EU are often misplaced. In addition it also indicates that a balanced outcome will need to ensure openness in other regions in addition to the EU. We have shown our willingness to further open our markets, but if all developing countries are to gain from the DDA we cannot be the only ones to do so. A balanced outcome means movement by all key actors to ensure that all countries, including the poorest can reap the benefits of a freer global trading system. Without such balance the potential for preference erosion to cause difficulties for several countries will be much more significant.

Statistical Annex

Table 1 - EU imports from key DC suppliers, € Bn

Source: Eurostat Statistical regime 4

	2000	2001	2002	2003	2004	2005
Mediterranean countries	63	66	65	65	74	88
ACP countries excl S Afr	29	32	30	29	29	36
DC FTA	27	29	27	26	30	34
LDCs **	12	14	13	13	14	16
LDC non ACP **	4	4	4	4	5	5
South Africa	14	16	16	15	16	17
Mexico	7	7	6	6	7	9
Chile	5	5	5	5	7	8
Other DCs	247	240	231	247	298	364
All DCs	449	440	423	438	515	612

Table 2 - EU25 Imports by sector

	million euro					
Source Eurostat, statistical regime 4	2000	2001	2002	2003	2004	2005
ALL PRODUCTS						
World	943.843	927.344	882.015	875.819	1.008.173	1.173.926
Developing countries*	448.631	440.384	423.266	438.381	514.585	612.389
DCs MFN:	79.184	69.942	66.385	66.865	78.540	85.750
Mediterranean countries	62.730	66.002	65.038	65.008	74.296	88.061
ACP countries excl S Afr	28.867	31.629	30.052	29.219	29.193	36.083
South Africa	14.475	16.021	15.636	14.791	15.673	16.728
Mexico	7.042	7.384	6.222	6.188	6.760	8.970
Chile	5.113	5.109	4.834	4.891	7.187	7.844
EBA non ACP **	4.024	4.270	4.078	4.443	5.200	5.071
Other DCs	247.196	240.027	231.021	246.975	297.736	363.880
LDCs **	12.325	13.749	13.400	12.563	13.826	15.883
Myanmar	407	490	440	384	459	287
AGRICULTURAL PRODUCTS (AMA)						
World	61.482	65.426	65.726	64.472	68.507	73.687
Developing countries*	27.074	28.205	26.861	26.689	31.983	31.976
DCs MFN:	2.461	2.492	617	512	363	387
Mediterranean countries	8.919	9.484	8.333	8.556	9.548	11.754
ACP countries excl S Afr	8.171	8.820	10.410	9.066	8.576	8.677
South Africa	1.642	2.159	2.637	2.017	2.020	2.008
Mexico	593	574	503	459	434	509
Chile	1.154	1.441	1.406	1.422	1.643	1.782
EBA non ACP **	239	242	253	268	256	281
Other DCs	3.895	2.992	2.702	4.389	9.143	6.578
LDCs **	2.368	2.283	2.306	2.225	2.219	2.494
Myanmar	23	25	25	18	16	20

INDUSTRIAL PRODUCTS (NAMA)						
World	882.360	861.917	816.289	811.347	939.666	1.100.239
Developing countries*	421.557	412.179	396.405	411.691	482.602	580.413
DCs MFN:	76.724	67.450	65.768	66.353	78.177	85.363
Mediterranean countries	53.811	56.518	56.705	56.452	64.748	76.307
ACP countries excl S Afr	20.696	22.810	19.641	20.153	20.617	27.406
South Africa	12.832	13.862	12.998	12.775	13.654	14.720
Mexico	6.449	6.810	5.719	5.729	6.326	8.461
Chile	3.959	3.667	3.429	3.468	5.543	6.062
EBA non ACP **	3.785	4.028	3.825	4.175	4.943	4.790
Other DCs	243.301	237.035	228.319	242.586	288.593	357.303
LDCs **	9.956	11.465	11.093	10.338	11.607	13.389
Myanmar	385	465	415	366	443	267
FISH AND CRUSTACEANS (HS 03)						
World	9.265	10.221	9.737	9.721	9.804	11.216
Developing countries*	5.355	6.186	5.839	6.114	5.951	6.687
DCs MFN:	126	176	178	174	120	129
Mediterranean countries	521	583	641	621	578	674
ACP countries excl S Afr	1.182	1.304	1.297	1.219	1.163	1.181
South Africa	191	217	230	235	241	226
Mexico	34	37	52	34	29	37
Chile	195	259	247	226	261	355
EBA non ACP **	190	199	205	215	197	220
Other DCs	2.917	3.410	2.989	3.391	3.361	3.866
LDCs **	876	971	1.015	929	852	928
Myanmar	17	17	16	14	14	16
ENERGY (HS 27)						
World	145.983	141.617	134.822	142.686	186.429	266.408
Developing countries*	88.650	81.878	72.649	75.918	91.824	129.973
DCs MFN:	22	31	270	188	266	988
Mediterranean countries	17.630	17.006	16.560	15.300	16.068	22.123
ACP countries excl S Afr	8.770	9.260	8.268	8.457	7.501	13.190
South Africa	1.462	2.111	1.864	1.891	2.550	2.911
Mexico	1.667	1.516	1.507	1.301	1.573	2.313
Chile	2	7				2
EBA non ACP **	46	37	11	16	13	46
Other DCs	59.052	51.911	44.168	48.765	63.853	88.400
LDCs **	1.627	2.157	2.496	1.766	1.808	3.870
Myanmar						
TEXTILE (HS 50-63)						
World	62.235	64.139	63.305	62.747	67.977	72.998
Developing countries*	49.984	50.836	50.761	50.700	55.454	61.167
DCs MFN:	6.392	5.505	4.899	4.322	4.164	3.580
Mediterranean countries	14.174	15.296	16.065	16.196	16.961	17.143
ACP countries excl S Afr	1.623	1.573	1.261	1.091	1.086	904
South Africa	275	272	271	278	274	241
Mexico	80	89	99	94	95	94
Chile	14	12	15	15	13	8
EBA non ACP **	3.316	3.612	3.508	3.805	4.603	4.381

Other DCs	24.110	24.477	24.643	24.900	28.258	34.816
LDCs **	3.893	4.158	3.882	4.134	4.948	4.710
Myanmar	301	390	326	301	373	194
OTHER PRODUCTS						
World	664.877	645.940	608.425	596.193	675.457	749.616
Developing countries*	277.568	273.278	267.156	278.958	329.373	382.587
DCs MFN:	70.184	61.737	60.422	61.669	73.627	80.665
Mediterranean countries	21.486	23.633	23.438	24.335	31.141	36.368
ACP countries excl S Afr	9.122	10.673	8.816	9.386	10.867	12.132
South Africa	10.904	11.261	10.633	10.371	10.589	11.342
Mexico	4.667	5.168	4.060	4.300	4.629	6.018
Chile	3.748	3.390	3.167	3.227	5.270	5.698
EBA non ACP **	233	180	100	139	129	144
Other DCs	157.224	157.237	156.520	165.530	193.121	230.220
LDCs **	3.560	4.180	3.701	3.510	3.998	3.881
Myanmar	67	58	72	51	56	57
<i>*incl Turkey and excl Myanmar</i>	EBA non ACP**: Afghanistan, Bangladesh, Bhutan, Cambodia, Lao Dem Rep, Maldives, Nepal, Yemen.					
<i>World excl intra-EU25</i>	DCs MFN: Hong Kong, Korea, Singapore, Taiwan					

Table 3 - EU15 Imports, Use of Preferences

	2003	2004
Developing countries*	74	70
Mediterranean countries	85	83
ACP countries excl S Afr	96	96
South Africa	85	86
Mexico	82	81
Chile	89	95
EBA non ACP	60	62
Other DCs	70	65
LDCs	83	83

Source: Eurostat, statistical regime 1