



European Development
Cooperation Strengthening
Programme (EDCSP)

The next decade of EU trade policy:

Confronting global challenges?



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Abbreviations

ACP	African, Caribbean and Pacific	HDI	Human Development Index
AFD	<i>Agence Française de Développement</i> (French Development Agency)	HIC	High-Income Country
AfT	Aid for Trade	ICT	Information and Communication Technology
AOSIS	Alliance of Small Island States	IDA	International Development Association
ASEAN	Association of Southeast Asian Nations	IFC	International Finance Corporation
AU	African Union	IMF	International Monetary Fund
AUC	African Union Commission	IPR	Intellectual Property Right
BIS	Bank for International Settlements	ITF	Infrastructure Trust Fund
BRICS	Brazil, Russia, India, China and South Africa	JVI	Joint Vienna Institute
BTA	Border Tax Adjustment	KfW	<i>Kreditanstalt für Wiederaufbau</i> (German Development Bank)
CAP	Common Agricultural Policy	LCA	Long-term Cooperative Action
CARIFORUM	Caribbean Forum	LDC	Least Developed Country
CBDR	Common but Differentiated Responsibilities	LIC	Low-Income Country
CDM	Clean Development Mechanism	LMIC	Lower-Middle-Income Country
CER	Certified Emissions Reduction	MFN	Most-favoured nation
CET	Common External Tariff	MIC	Middle-Income Country
COMESA	Common Market for Eastern and Southern Africa	NIC	Newly Industrialised Country
COP	Conference of the Parties	NIF	Neighbourhood Investment Facility
CRS	Creditor Reporting System (OECD)	NTB	Non-trade Barrier
CRW	Crisis Response Window (IDA)	ODA	Official Development Assistance
DAC	Development Assistance Committee (OECD)	ODI	Overseas Development Institute
DCI	Development Cooperation Instrument	OECD	Organisation for Economic Co-operation and Development
DDA	Doha Development Agenda	PCD	Policy Coherence for Development
DFI	Development Finance Institution	PNG	Papua New Guinea
DTIS	Diagnostic Trade Integration Study	PTA	Preferential Trade Agreement
EAC	East African Community	R&D	Research and Development
EBA	Everything But Arms	RDB	Regional Development Bank
EBRD	European Bank for Reconstruction and Development	REDD+	Reducing Emissions from Deforestation and Forest Degradation
EC	European Commission	RTA	Regional Trade Agreement
ECOWAS	Economic Community of West African States	SADC	Southern African Development Community
EDF	European Development Fund	SEZ	Special Economic Zone
EIB	European Investment Bank	SMEs	Small and Medium Enterprises
EIT	Economy in Transition	SPS	Sanitary and Phyto-sanitary
EITI	Extractive Industries Transparency Initiative	SVE	Small and Vulnerable Economy
EPA	Economic Partnership Agreement	SWAp	Sector-wide Approach
ETS	Emissions Trading Scheme	UK	United Kingdom
EU	European Union institutions and Member States	UMIC	Upper-Middle-Income Country
FDI	Foreign Direct Investment	UNFCCC	United Nations Framework Convention on Climate Change
FLEG	Forest Law Enforcement, Governance and Trade	VAT	Value-added Tax
FTA	Free Trade Agreement	V-FLEX	Vulnerability FLEX
G20	Group of 20	WTO	World Trade Organization
GDP	Gross Domestic Product		
GSP	Generalised System of Preferences		

Executive Summary

 On 27 January 2012, the European Commission (EC) published a Communication 'Trade, Growth and Development: Tailoring trade and investment policy for those countries most in need'. It is the first on the topic since 2002, and is intended to set out a direction of travel for the next decade. The communication (a) reviews changes in the world ('the great reshuffle'), (b) summarises what the EU has achieved over the past decade in terms of trade and investment policy with respect to developing countries, and (c) lays out an agenda to 2020 or so, for the EU itself and within the multilateral context. There is also a short section on what developing countries must do.

In response, the EU Council issued its Conclusions on 16 March, stating that the Council is committed to (1) promoting a multilateral agenda for trade and development (e.g. pursuing the Doha Round and the LDC package); (2) promoting market access for developing countries (e.g. the Generalised System of Preferences (GSP), Economic Partnership Agreements (EPAs)); (3) working towards sustainable development through a green economy (e.g. liberalisation of green goods and services, financing and public-private partnerships); and (4) developing more focused, targeted and coordinated Aid for Trade (AfT).

Because of the potentially wide-ranging impact of the Communication, framing trade policy for a decade amidst the middle of large global shocks, we commissioned 18 essays from the world's leading trade and development experts to discuss the main issues covered. We divided the essays into four separate groups:

1. General views on the EC Communication on Trade, Growth and Development;
2. Trade-related instruments to support trade, investment and growth;
3. Other instruments to support trade, investment and growth; and
4. Regional views on the EC Communication.

These essays suggest there is much to celebrate in the EU documents, for example:

- The identification of a number of global challenges, called a 'reshuffle';
- The recognition of some major dilemmas, such as (1) whether and how to differentiate in a heterogeneous world, and (2) whether to use trade and investment policy to address climate change and other environmental problems; and
- The formulation of good solutions such as targeted AfT and some other possible offers in the Communication, but which are narrowed down significantly in the Council Conclusions.

However, these essays also flag up a series of major concerns, which we have grouped into five categories:

1. There is a major concern that the EU is moving towards protectionism

A major worry expressed by several authors is that the EU will retreat into protectionism (e.g. vis-à-vis BRICS) in the range of trade-related economic policies. Clearly, GSP reform is likely to impose more trade barriers on a range of products and countries when they are not benefiting from a reciprocal Free Trade Agreement (FTA) with the EU. This does not offer the best value for EU consumers, and such threats are not confined to tariffs. The EC has issued a proposal to close government procurement markets to firms from countries that exclude European firms. Is this part of a trend in protectionist measures that many of us feared would happen in difficult economic times? Should the response not relate to how to make use of growing markets outside the EU?

2. There is no clear strategy behind the EU's approach towards differentiation, which is currently applied largely on an ad hoc basis

There is a clear danger that differentiation in the area of trade will be applied without consideration of economic principles and without a clear strategy that brings together the various fields in which differentiation can be applied: aid, trade, climate change, etc. For example, trade theory suggests that lower tariffs (including those applied to emerging powers) are always better, and that differentiation is a distraction. On the other hand, it seems difficult to defend (on a 'needs' basis) aid to The Group

of 20 (G20) countries at the end of the decade. Moreover, environmental changes are in the hands of emerging powers, which should increasingly, and proportionally to their development stage, contribute to the solutions to climate change and natural resource scarcity.

3. The Communication neglects the importance of non-trade policies for developing country growth and fails in its duty to promote Policy Coherence for Development (PCD)

There is a missed opportunity to make non-trade policies coherent with development goals. The obvious example is the Common Agricultural Policy (CAP), which is clearly at odds with development goals. There are myriad ways to achieve the stated goals of the CAP without having to pay economically inefficient and environmentally harmful subsidies to a selected group of European farmers. There seems to be no sense of urgency in the need for step changes in PCD.

4. The EU is taking the wrong approach to the role of trade in tackling global problems

The EU has a very defensive position on the role of trade in tackling global challenges like climate change and food security, even threatening to impose trade barriers for green purposes. In fact, the opposite needs to occur: free trade can help countries to reap the benefits of economies of scale in green industries and can provide access to water, land and hence food, as long as there are no trade (tariff and non-tariff) barriers.

5. Trade policy has little meaning without being embedded in and linked to policies for growth

Trade and investment policy do not have a one-to-one causal relationship with growth, and seem largely irrelevant in, for example, the Pacific. Instead, in that region, the EU should be problem-focused and examine how it can contribute, with what type of support. Thus, it could support developing country initiatives, policies and institutions for good governance, industrialisation and diversification, regional integration efforts and systems to manage Aft, as these are required to make EU trade and investment policies work for development.

So trade is not the single panacea for one single challenge, but it helps to achieve a range of policy objectives, and its role will vary enormously from one context to the next.


In addition to the above five points, there are a number of concerns that will become urgent policy issues for the EU in 2014 unless they are contained. For example, what will happen to African, Caribbean and Pacific (ACP) countries that have not signed up to an EPA when they lose trade preferences, or current GSP beneficiaries when they lose preferences? Or what will happen when the CAP is not reformed despite it being economically inefficient, financially expensive and environmentally unsustainable? These are all issues that should become clearer before 2015, the next milestone for the EU's trade strategy.

Indeed, by 2015, the EC needs to report on progress on the Communication and Council Conclusions to the Council. Our checklist of questions the report will need to answer includes:

- Has the EU been able to fight protectionism and not given in to protectionist forces?
- Has the EU developed an overarching strategy on differentiation?
- Has the EU succeeded in placing trade and related policies as part of the PCD agenda and delivered step changes in PCD?
- Has the EU mainstreamed trade throughout its work on climate change and natural resource scarcity?
- Has the EU linked trade policy better to a country's growth strategy?
- Has the approach towards EPAs, GSP and CAP been satisfactory and not harmed relationships with developing countries?

The EU's new trade policy

The EC's Communication and the Council Conclusions on Trade, Growth and Development

 On 27 January 2012, the European Commission (EC) published a policy proposal – a ‘Communication’ on ‘Trade, Growth and Development: Tailoring trade and investment policy for those countries most in need’. The Communication is the first on the topic since 2002, and is intended to set out a direction of travel for the next decade. The table of contents is reproduced in Box 1. The paper (a) reviews changes in the world (‘the great reshuffle’); (b) summarises what the EU has achieved over the past decade in terms of trade and investment policy with respect to developing countries; and (c) lays out an agenda to 2020 or so, for the EU itself

and within the multilateral context. There is also a short section on what developing countries must do.

On changes in the world, the paper draws attention to the rapidly changing world. There has been rapid growth in several emerging powers and much of Africa is also continuing to grow, with openness to trade and investment playing a supporting role. However some countries have been left behind: the majority of Least Developed Countries (LDCs) have not been able to transform their economies structurally. In addition, there are new challenges to be faced, such as threats to the climate and natural resource base.

Box 1: Trade, growth and development: tailoring trade and investment policy for those most in need

1. Purpose
2. A changing world
 - 2.1. The great reshuffle in the world economic order
 - 2.2. Lessons for trade and investment policies for development
3. What we have done so far
 - 3.1. Innovative autonomous schemes
 - 3.2. Leading on Aid for Trade
 - 3.3. Renewed bilateral and regional efforts
 - 3.4. Mixed global picture
4. Tasks for the next decade
 - 4.1. What Europe can offer
 - 4.1.1. More focused preferences
 - 4.1.2. Better targeted Aid for Trade
 - 4.1.3. Complementary instruments boosting fdi
 - 4.1.4. Comprehensive and modulated bilateral/regional agreements
 - 4.1.5. A values-based trade agenda to promote sustainable development
 - 4.1.6. Helping vulnerable countries improve their resilience and response to crisis
 - 4.2. Domestic reforms and good governance are key to trade-led growth
 - 4.3. The multilateral agenda until 2020
 - 4.3.1. Delivering on the development dimensions of the Doha Development Agenda
 - 4.3.2. Setting a firm basis for the future
 - 4.3.3. Tackling emerging challenges
5. Conclusion

As far as EU actions are concerned, the paper celebrates that the EU has put in place the Everything but Arms (EBA) initiative (duty free quota free access for LDCs), a new Generalised System of Preference (GSP) and reformed its rules of origin, as well as stepping up Aid for Trade (AfT). It also mentions Economic Partnership Agreements (EPAs), other free trade agreements (FTAs) and the World Trade Organization (WTO), where progress has been slow or deadlocked. The new Communication attempts to frame the EU's response to a growing differentiation amongst developing countries (e.g. LDCs vs the BRICS – Brazil, Russia, India, China and South Africa).

In terms of the agenda for 2020, there are six main priorities for EU action, plus additional priorities in the multilateral arena. The EU will focus its preferences towards LDCs, target AfT to LDCs, put in place complementary investment instruments, deal with FTAs (conclude EPAs, and agree a package for the Middle Eastern countries), put sustainable development measures at the forefront of the GSP+ and FTAs, support impact assessments, acknowledge private sector schemes and corporate responsibility, and build resilience against shocks.

It then argues that domestic actions and good governance are key to trade and growth, and that trade agreements can lock in domestic reforms. On the multilateral front, the EU proposes to support the development dimension of the Doha round of WTO negotiations (the LDC package), address emerging issues (e.g. trade and food security, achieving reliable energy supply, threats to natural resource base), and calls for emerging powers to provide more concessions to LDCs.

On 12 March, the EU Council discussed the trade Communication. The Council adopted Conclusions on the subject.¹ The Council Conclusions only amount to three pages, compared to 19 for the Communication.

It consists mainly of affirmations in the introduction. It underlines the importance of openness to international trade accompanied by adequate domestic policies and institutional reforms and the importance of the EU in trade and investment. It also sees that the LDCs risk further marginalisation, and calls for greater differentiation in the design and implementation of EU trade, investment and development policies. It underlines the importance of the multilateral approach and welcomes duty free and quota free access for LDCs under the EBA initiative. It argues that more needs to be done to support diversification of LDC economies and facilitate their access to EU markets, and that it is necessary to go beyond tariff reduction and address new issues including services, procurement and investments, and constraints associated with the business environment, productive capacity, infrastructure and social services, as well as the ability

to overcome technical barriers to trade. It emphasises the guiding role of Policy Coherence for Development (PCD) in the EU's trade and development policy and recognises the crucial role of the private sector and investment in creating growth and development. It also stresses the need to continue supporting regional integration processes

The Conclusions contain four sets of action to which the Council is committed: (1) promoting a multilateral agenda for trade and development; (2) providing market access for developing countries; (3) working towards sustainable development; and (4) targeted AfT.

1. Promoting a multilateral agenda for trade and development

The Council argues to preserve the multilateral trading system at the core of EU's trade, investment and development policy and to conclude the Doha Development Agenda (DDA). It invites the Commission to continue its work for concrete results in the WTO context, benefitting developing countries most in need and work for early results on trade facilitation, non-tariff barriers and dispute settlement. It argues that developed countries and developing countries in a position to do so should open their market, especially to LDCs, pushes for greater coherence in preferential rules of origin for LDCs, and wants to conclude the cotton negotiations soon. It also wants to enhance market transparency to mitigate excessive price volatility in commodity markets; facilitate the accession of LDCs to the WTO; follow-up the discussions on improving market access in services for LDCs, taking into account the services waiver for LDCs adopted in 2011; promote the use of intellectual property tools, including geographical indications, while giving favourable consideration to duly motivated requests for further extension of the Trade-Related Aspects of Intellectual Property Rights (TRIPS) implementation deadline for LDCs; and finally address emerging challenges such as food security, sustainable use of natural resources, access to energy supplies and climate change.

2. Providing improved market access for developing countries

The Council emphasises the importance of adopting the new GSP regulation no later than by 1 January 2014; speeding up bilateral and regional negotiations with developing countries; supporting rapid conclusions of EPAs; and stresses the importance of strengthening the EU's relations with countries in the Southern Mediterranean in response to the 'Arab Spring', and through the Eastern Partnership.

3. Working towards sustainable development through a green economy

The Council supports (1) the elimination of tariff and non-tariff barriers on goods and services that can deliver environmental benefits and support improved access to green technology; (2) green and inclusive growth as part of sustainable development through measures such as GSP+, bilateral and regional trade agreements, innovative financing and public-private partnerships, and by streamlining Sustainability Impact Assessments as a means of strengthening the sustainability dimension in EU's trade policy; (3) producers and traders in developing countries to engage in trade schemes based on sustainable criteria.

4. Developing more focused, targeted and coordinated Aid for Trade

The Council argues that the EU and its Member States should continue to lead global efforts to respond to the AfT demands because better targeted, result-oriented and coordinated AfT are important for the aid and development effectiveness agenda, focusing on LDCs and developing countries most in need. It also calls on the EC and Member States to coordinate better their aid for trade and increase the effectiveness of the Enhanced Integrated Framework (EIF). It encourages the EC to provide a package of support aimed at helping small-scale operators. It underlines the need to address the situation of vulnerable developing countries and strengthen their ability to cope with external shocks.

In the final paragraph, the Council invites the EC to provide a report on implementation of the Communication and the follow up to these conclusions in 2015.

Footnotes

1. Council of the European Union (2012) 'Conclusions on EU's approach to trade, growth and development in the next decade' (http://www.eu-un.europa.eu/articles/fr/article_11973_fr.htm).

Overview of this volume of essays

Dirk Willem te Velde

Growth and development are taking place in a rapidly changing world. There has been rapid growth in several emerging powers, and much of Africa is also continuing to grow, with openness to trade and investment playing a supporting role. But some countries have been left behind: the majority of Least Developed Countries (LDCs) have not been able to transform their economies structurally.

The share of the BRICS (Brazil, Russia, India, China and South Africa) in world gross domestic product (GDP) increased from 17% in 1990 to 28% in 2010, owing to the rise of China (13.5%) and India (5.5%), at the expense of Organisation for Economic Co-operation and Development (OECD) and European Union (EU) GDP. The share of sub-Saharan Africa and the LDCs in world GDP remained at 2% over the period. Nonetheless, sub-Saharan African growth turned around in the mid-1990s (before commodity prices began to rise and before the emergence of the BRICS in Africa), suggesting that improving policy and institutional changes has been key to African growth for some time. African policies performed remarkably well during the global financial crisis: there was no policy knee-jerk reaction, reform continued and economic performance was as expected (a 5% GDP level effect of the financial crisis over 2008-2010).

In addition, there are new challenges to be faced, such as threats to the climate and the natural resource base. A rising world population and global economic growth are placing new pressures on natural resources. Demand for energy and water is expected to grow by 40% and that for food by 50% by 2030 compared with present levels. The world has already transgressed three of the nine planetary boundaries within which it can operate safely: biodiversity loss, nitrogen and

phosphorus loading and climate change. Ocean acidification and freshwater boundaries are expected to be next in the coming 50 years. Is there a role for trade policy?

Now is the right time to be launching a Communication. The EC Communication on Trade, Growth and Development¹ launched on 27 January, sets the framework for its actions on trade and development in the coming decade. It updates a 2002 Communication on Trade and Development: Assisting Developing Countries to Benefit from Trade.² It coincided with a Staff Working Paper: Trade as a Driver of Development. The question addressed in this edited volume is: how should the EU's trade policy respond to the growing differentiation among countries and the growing list of global challenges?

The Communication has received a number of public comments. The EU Council issued its Conclusions on 16 March,³ stating that it is committed to 1) promoting a multilateral agenda for trade and development (e.g. pursuing the Doha Round and the LDC package); 2) promoting market access for development countries (e.g. the Generalised System of Preferences (GSP), Economic Partnership Agreements (EPAs)); 3) working towards sustainable development through a green economy (e.g. liberalisation of green goods and services, innovation of financing and public-private partnerships); and 4) developing more focused, targeted and coordinated Aid for Trade (AFT).

Because of the potentially wide-ranging impact of the Communication in unusual circumstances, framing trade policy for a decade amid large global shocks, we commissioned 18 essays from a range of trade and development experts. We divided the essays into four separate groups:

1. General views: trade, growth and development and the EC Communication;
2. Trade-related instruments to support trade, investment and growth;
3. Other instruments to support trade, investment and growth; and
4. Regional views on the EC Communication.

Four essays express general views on the Communication. Some responses point to a helpful Communication; others are more negative. Patrick Messerlin highlights the essence of the Communication in two areas: differentiation and trade and growth. Fredrik Erixon warns of the risk of EU protection and mentions in particular the problem of non-tariff barriers (NTBs) in agriculture. Oliver Morrissey suggests there is a need for growth and industrial policy to make integration work. San Bilal argues the EU needs to declare its own interest in trade and development and should not regard emerging market economies as competitors, to provide more details on regional integration and overall to be more ambitious in addressing challenges.

Six essays discuss trade-related instruments to support trade, investment and growth. Chris Stevens discusses GSP reform and argues that the proposed reform could be seen as a step towards protectionism, but the process changes the status of countries which could provide new impetus to trade negotiations. Ken Heydon reviews a number of key issues in trade and development, including the problems of preferences, the need to see trade policy in a broader framework and the need to ensure better access to the Dispute Settlement Mechanism (DSM) at the World Trade Organization (WTO). Chris Stevens discusses where next on EPAs and predicts problems ahead on EPA implementation. Jodie Keane warns that climate change will affect small and vulnerable economies (SVEs) in particular and that new climate mitigation schemes intersect. Dirk Willem te Velde finds that, while raw materials have been addressed, new challenges in access to water and land also require attention in the future in the form of open trade rules. Finally, Nicola Cantore discusses reform of the Common Agricultural Policy (CAP) and suggests that, given the need for Policy Coherence for Development (PCD), it is important to consider the effects of the CAP.

There are four essays on other instruments to support trade, investment and growth. Yurendra Basnett confirms that AfT is often effective, but its effectiveness can be enhanced through better use of in-country systems. Stephany Griffith-Jones and Dirk Willem te Velde applaud the recent use of shock facilities (V-FLEX) and argue that, in future, significant attention needs to go to resilience building, especially in good times and compensating the poorest countries in bad times. The new EU compensatory facilities have to build on the successful V-Flex experience and be speedy in disbursement and sufficient scale to deal with likely continued large shocks. Dirk Willem te Velde argues that there is a need for a clearer strategy behind instruments to support foreign direct investment (FDI) and make it work for development. Finally in this section, Siân Herbert shows that differentiation, a key issue in the Communication, not only is a trade issue but also applies to climate change and aid.

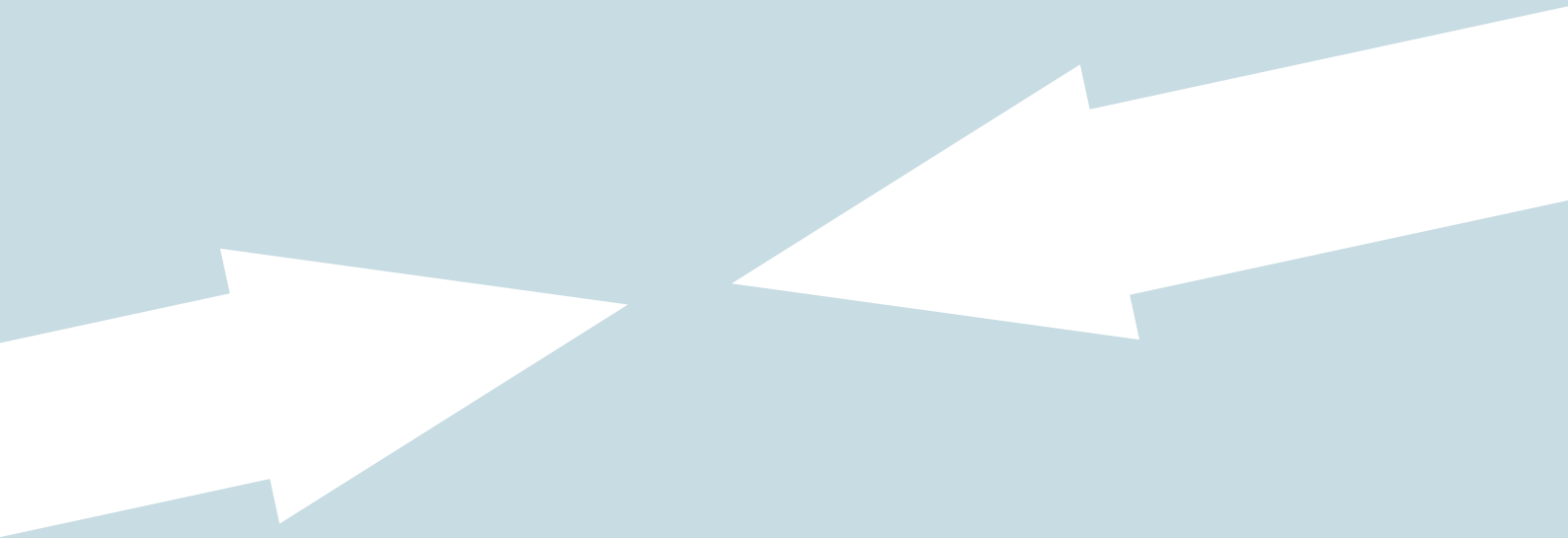
The final set of essays contains views from developing country regions. Ali Mansoor, Vishnu Bassant and Salomon Samen provide a perspective from Mauritius, which is very concerned with moving ahead with regional negotiations, kick-starting services negotiations and moving to plurilateral negotiations. Nik Soni and Derek Brien comment on the irrelevance of the trade Communication to the Pacific region. We also reprint comments by Pradeep Mehta, Bipul Chatterjee and Federico Lupo Pasini. Finally, Christian Kingombe and Dirk Willem te Velde argue that now is the right time to embark on a regional approach, using the African Union (AU), to trade and especially in services.

The final essay draws all the others together and contains a set of conclusions. This also looks ahead and asks what the EC needs to consider when it reports to the Council on implementation of the Communication and follow-up on the Council Conclusions in 2015.

Footnotes

1. European Commission (2012) 'Communication from the Commission to the European Parliament, the Council and the European Economic and Social Committee. Trade, growth and development. Tailoring trade and investment policy for those countries most in need' (http://trade.ec.europa.eu/doclib/docs/2012/january/tradoc_148992.EN.pdf).
2. European Commission (2002) 'Communication from the Commission to the Council and the European Parliament. Trade and Development. Assisting Developing Countries to Benefit from Trade' (http://trade.ec.europa.eu/doclib/docs/2004/april/tradoc_111245.pdf).
3. Council of the European Union (2012) 'Conclusions on EU's approach to trade, growth and development in the next decade' (http://www.consilium.europa.eu/uedocs/cms_data/docs/pressdata/EN/foraff/129019.pdf).

General Views



The EC Communication on Trade, Growth and Development:

Where Is the Strategy?

Patrick Messerlin

In January 2012, the European Commission (EC) released a Communication stating its views on the EU trade–growth–development policy nexus for the coming decade. This is organised in a complex three-step framework: priorities for the decade; recommendations supporting these priorities; and initiatives supporting these recommendations. As the Communication deals with an extremely wide range of issues, it is beyond the scope of this brief section to do justice to all its aspects. Rather, it discusses the rationale behind what are supposed to be the two strategic pillars of the Communication.

Priorities: the value of ‘differentiation’

The Communication’s first priority calls for more *‘differentiation among developing countries in order to focus on the poorest’* and coping with widening differences among developing countries. It defines differentiation as entailing a broadening of the range of EU trade measures: *‘emerging economies and poorer ones have different potentials, needs and objectives, thus [require] a different policy approach’*.

At first glance, the Communication’s approach looks attractive. However, it raises two fundamental questions;

First, it does not fully draw lessons from the way China has been integrated into the world economy during the past three decades. Before its accession to the WTO, from the mid-1980s to the early 2000s, China pursued a steady unilateral liberalisation. Then, China agreed to a Protocol of Accession to the WTO which imposed on it much deeper and wider concessions than for all the other WTO members. These harsh conditions raise serious questions as to the ultimate value of an approach based on differentiation.

China has shown that a sound domestic agenda and the ability to stick to this and to make trade policy supportive of it (and not a quasi-autonomous policy) are much more powerful drivers of successful development than differentiating the trade policy of its trading partners.

On the EU side, differentiation generates a serious problem the Communication does not examine. A differentiation policy opens the door to a potentially unlimited list of different trade (and non-trade) measures, each of them tailor-made to different developing countries. The more numerous these measures, the harder it is for the EU to integrate them into a consistent EU trade policy. This difficulty is amplified by the fact that a comatose Doha leaves preferential trade agreements (PTAs) as the only instrument left for market opening, which presents the risk of very diverse PTA texts, including in terms of legally binding commitments. The current EU PTAs show that the value of non-binding texts is highly questionable, since such texts create too high expectations, leading to commensurably high disillusion.

Recommendations and initiatives

The Communication then goes on listing recommendations and initiatives. The list is so long it makes the reader dizzy, and is so heterogeneous one wonders about its central rationale. Moreover, it is so profuse in good intents that credibility becomes questionable: its high praise of Economic Partnership Agreements (EPAs) with the African, Caribbean and Pacific (ACP) countries does not fit with the lack of enthusiasm of these countries to conclude them; environmental reforms are not valued highly in the world’s poorest world countries – poverty imposes growth at any cost; and the link between trade policy and democratic reforms is (unfortunately) tenuous.

Of course, some topics mentioned by the Communication should easily gather a wide consensus: trade facilitation, FDI and services, for instance. But other components – social and environmental regulations, intellectual property rights (IPRs), competition policy, to mention a few of them – raise a host of questions and deserve much more careful justification of their presence in the Communication.

The Communication rarely takes pain to justify these topics – the extent to which trade policy contributes to a solution to the problems at stake or is conducive to growth. For instance, what is the value of an initiative *‘facilitating the use of intellectual property tools [what is the difference between tools and rights?] by small producers and farmers’*? As an example, geographical indications have been available to French wine producers for decades, yet have been very successful in Champagne and disappointing in Bordeaux. As both rely on small farmers, success and failure depend on something else – the fact that Champagne relies on a concentrated sale structure that does not exist in the Bordeaux case. The initiative suggested by the Communication is not helpful here.

Justifying measures would be all the more useful because the Communication itself shows the limits of trade policy, as illustrated by the additional preferences granted to Pakistan following the floods of July 2010. In this case, the Communication:

- First acknowledges that these additional preferences did *‘not trigger a swift enough reaction’*. This suggests what was at stake was Pakistan’s capacity to mobilise other products for exports, mainly meaning domestic supply problems (not trade ones). In short, additional preferences did not resolve whether the problem at stake was a trade problem (possibly calling for trade measures);
- Then mentions that these additional preferences *‘caused concerns as to the possible trade diversion impact on other poor economies’*. This remark underlines the risks of multiplying trade measures in an integrated world economy in which every measure can have unintended and substantial effects on other measures. Multiplying measures risk lowering their efficiency.

Finally, the Communication leaves the reader with an uneasy feeling on two levels. Economists know trade policy is a very attractive instrument because it looks powerful, but its power can easily turn good intentions into ‘hell’. Meanwhile, foreign affairs specialists feel this Communication goes much too far in matters which are fundamentally – and should remain – the domain of foreign affairs.

The EC Communication on Trade, Growth and Development

– Comment

Fredrik Erixon

There are some interesting ideas and proposals in the European Commission's (EC) new Communication on Trade, Growth and Development. After a decade as a leader in Aid for Trade (Aft), the EU now wants to reform its aid component in trade policy by concentrating it on Least Developed Countries (LDCs). Even if the proposals presented in the new strategy will not amount to a radical overhaul of current policy, they are important signals that the EC now stands ready to spearhead reforms of its own as well as Member States' donations to trade capacity building. For inside-Brussels beltway observers, there are also some interesting nuances in the Communication. The language on a development package in the Doha Round negotiations, for example, differs from previously published strategies insofar as a development package is not explicitly conditioned on success in other negotiating areas.

Finally, the Communication also puts emphasis on some critical aspects of trade and development that often are neglected – for instance the inarguable fact that trade openings by the EU or other economies will not translate into many new trade gains for LDCs unless they reform their economic policy and institutions to a much greater degree than they have so far. Furthermore, it points out that, in many instances, it is not a specific developing country aspect of trade policy that will help boost these countries' trade. What many (but not all) developing countries would benefit from are exactly the same trade reforms that other countries favour other countries undertaking: reduced or eliminated market access restrictions combined with a growth-friendly regulatory environment based on transparency and predictability.

Yet there are few things in the Communication that will catch the attention of key policymakers in developing country capitals or make a difference in those countries' efforts to grow their economies through trade. If the

ambition with the Communication was to put forward a new component in EU trade policy, exclusive to developing countries, it is difficult to reach any other conclusion than that the EC has failed. Rehearsing many strategies from the past six years, since the launch of Global Europe, the Communication rather confirms that specific development aspects of trade policy are low on the agenda and that the EU is not planning to promote them.

This is not surprising. Nor should it necessarily be seen as a deliberative disinterest in promoting development through trade. Events in the past years have pushed the EU to give higher priority to other objectives in trade policy. Four years of crises in the EU – to be followed by what looks like at best anaemic economic growth for the rest of this decade – have strengthened those in the EU who favour a trade policy of a mercantilist (if not protectionist) bent. Together with the collapse of the Doha Round, these crises have provoked the other and less defensive wing of EU membership to pay higher attention to bilateral trade deals with other big economies – trade deals that could help the EU itself to expand trade and economic growth to a significant degree.

There are four concerns with this Communication. First and foremost, it fails to include reforms of EU policy that would have a beneficial effect on developing country exports to the EU. Prime among these absent policies is one related to agriculture. The EU is already operating a one-way free trade policy for LDCs as far as tariffs are concerned. This is a good policy, and the Communication rightly claims the so-called Everything But Arms (EBA) initiative has had a discerning effect on LDC exports to the EU. But developing countries that are not in that LDC group would also benefit from similar access to the EU market – which would probably not have eroding effects on exports from LDCs. And those developing countries, especially the big and populous ones, have more poor people than the LDCs.

Furthermore, there are many other restrictions than tariffs in the agriculture sector. In the agriculture and horticulture sectors, it is not always tariffs that present the biggest problems for potential exporters. Non-Tariff Barriers (NTBs) that are onerous and arcane tend to have a considerable trade-depressing effect. And the EU has not been shy in expanding its NTBs in the agriculture sector. Sanitary and phyto-sanitary (SPS) NTBs have proliferated, frequently through food safety regulations. This is not to say that such regulations are unjustified. The problem, however, is that many of them have been designed in an overly trade-restrictive manner (e.g. recent bans of Brazilian meat and Egyptian seed) and that the risk management process leading to new regulations, or application of regulations, is not very transparent. Moreover, the expansion of the SPS NTBs has led to too high compliance costs for many developing country exporters.

Second, and following on from the last comment on NTBs, the EU fails to understand that many of the new sustainability criteria it has introduced, especially in the farm, food and forestry sectors, have disproportionate effects on many developing countries that cannot comply with the new standards. This is not a black and white issue – and several developing countries should take greater responsibility for sustainability. But the issue here is rather that the EU has or will use ham-fisted restrictions to its own market as tools either to force through changes in developing countries or, as in the case of biofuels, to help to protect local production in Europe at the expense of foreign producers. As far as the Communication has anything to say about new sustainability standards, it presents them as development friendly. This is a distortion of facts – and several developing countries have already called their bluff. But the question remains: will the EU uphold and establish new sustainability standards (as planned) even when they limit production in and export from developing countries?

Third, the EU's specific trade policy towards Africa is limited to concluding the remaining Economic Partnership Agreements (EPAs). Judging by previous attempts to negotiate EPAs, this is an ambition that may prove impossible to meet. The configuration of EPAs seems to have been flawed from the start, but it may be too late to change that now. What the EU can do, however, is help to design a beyond-EPA trade policy, which could include, for instance, ambitions to promote regional trade integration in Africa in selected areas like services.

Lastly, the flagship reform in the Communication – a reform of the GSP – is disingenuous. It fails to convince anyone. It is not grounded in good economic analysis of the role of trade in development. The reform is sold on the premise that export to the EU from countries that will be disqualified from the GSP will be substituted by export from LDCs. That is a very dubious proposition. Rather, the GSP reform looks like a suspicious attempt to put pressures on middle-income developing countries to conclude new free trade agreements (FTAs) with the EU. We are in favour of such agreements, but the GSP system is not the right place for exerting such pressures.

It is understandable that a system of preferences adjusts itself to differences between developing countries. It is also understandable that the EU, like many other countries, is grappling with how to differentiate between developing countries with a small role in the global economy and those with a systemically important role. But adjustment by increasing tariffs on those countries that have enjoyed good economic development (but still have a large share of the population living in poverty) will have negative consequences – for them as well as for the EU.

The EC Communication on Trade, Growth and Development

– Comment

Oliver Morrissey

While the EC Communication reiterates worthy commitments, it is based on a somewhat optimistic view of how integration, investment and trade are related to promote economic growth. In this view, export opportunities (such as those provided by trade preferences) are realised and attract more investment which enhances productivity and further increases exports. Regional integration is beneficial as it provides more trade opportunities and regional efficiency gains, attracting more investment that generates more benefits. A virtual trade–investment–integration cycle emerges and growth follows.

However, there is very little evidence to support this view for countries in sub-Saharan Africa. Many such countries have posted good growth rates over the past decade; in most, this is attributable largely to a stable macroeconomic environment; in only a few (mostly those exporting mineral commodities to China) have exports played a major role. The majority continue to exhibit a structural weakness: they are over-reliant on primary commodity exports with too little local processing value-added and relatively small manufacturing sectors.

Trade preferences can be viewed as part of the problem. As EU preferences for sub-Saharan Africa are most pronounced for unprocessed commodities, they reinforce the structural deficiencies (and preference margins have steadily been eroded over time). Integration involving countries with productive structures geared to unprocessed exports generate limited intra-regional trade, and foreign investment is attracted into the same extractive sectors. Thus, features of integration, trade and investment have prevented the virtuous cycle. If future integration and investment are to help in breaking out of this cycle, the problems

of the past must be recognised by emphasising intra-regional trade and investment to generate linkages with domestic productive activities.

Although promoting regional integration is an objective of Economic Partnership Agreements (EPAs), relatively limited attention has been given to how the structure of agreements could support and facilitate regional integration. The introduction of reciprocity under an EPA may reduce intra-regional trade within sub-Saharan African regions, either directly if the elimination of the tariffs on European imports displaces existing regional suppliers or indirectly if imports from the EU displace domestic production and reduce regional production capacity and future prospects for intra-regional exporting. If the EU is to persist with the EPA strategy, it must recognise regional needs.

These threats to intra-regional trade can be offset in a number of ways. Sub-Saharan African regions will be tempted to draw up long lists of sensitive products for which tariff elimination on EU imports is postponed. If these are chosen to serve the protection interests of individual countries, they will undermine both the EPAs and the region's integration. If products traded within the region are deemed sensitive for EPAs, this may support regional integration. This could be underpinned if the EU provides 'aid for regional trade' and support for measures that enhance sub-Saharan African export capacity for both intra- and extra-regional trade. This support will be more effective if it is directed at products with the potential for intra-regional trade and local value-added productivity to encourage productivity and technology gains. In order for exporters to benefit from spillovers, they must increase processed exports; supporting this through EPAs will involve different types of preferences and more favourable rules of origin.

For example, although northern Ghana may not have

sufficient local production of tomatoes to support a canning factory, the region may have. Weak intra-regional transport and distribution infrastructure is recognised as a constraint throughout sub-Saharan Africa. There is a willingness to address this, but projects should be identified where there is the potential to encourage processing. This will mostly be in agri-processing but would then be consistent with existing intra-regional trade; the level of actual and potential cross-border trade should not be underestimated, even if it is under-recorded.

In addition to addressing the types of goods that are traded, there should be consideration of the sectors in which there is investment (and domestic is as important as foreign). The emphasis on investment in the Communication is largely that gains from integration are enhanced if appropriate measures are in place to encourage Foreign Direct Investment (FDI). FDI is likely to benefit sub-Saharan African countries only if it provides both linkages to and spillovers for domestic activities, both of which have been lacking in the region. Linkages can arise through employment, demand for inputs from local suppliers and supply of inputs to local producers; the linkages can then generate spillovers. Foreign firms may train workers and enhance their skills, but this benefits local firms only if workers move, and there is only limited labour mobility between firms in the region. Even if foreign firms supply/demand inputs to/from local producers, the linkage may not generate spillovers, because the foreign firm does not build a 'transfer relationship' with local firms or local firms have no capability to benefit from the know-how transfer. Domestic investment associated with clusters is more likely to generate spillovers. In general, FDI in manufacturing provides the strongest linkages and spillovers. The domestic manufacturing sector is quite small in sub-Saharan Africa, with little FDI in manufacturing, so actual linkages are few and spillovers are rare. Most FDI to the region is in the resource extraction sectors; this provides employment but few linkages to domestic firms and even fewer, if any, spillover opportunities. There will only be spillovers from FDI if the foreign firm or investor has technology and know-how that could be of use to local firms and is willing to transfer some of this. Arguably, sub-Saharan African countries need some mechanism to facilitate the transfer and utilisation of know-how by local firms to ensure effective spillovers. This suggests a role for government in promoting industrial policy.

A particular policy weakness evident in most sub-

Saharan African countries is the absence of a coherent industrial policy that supports local firms in acquiring the capabilities to benefit from technology and know-how transfer. Similar deficiencies are evident in agriculture, where policies have failed to embed productivity and technology gains. These two deficiencies can be addressed through policies that focus on developing agri-business. Some countries have pockets of activity, such as cut flowers, horticulture and fruits, where foreign investors have had an impact. Too often, this is limited to providing information on foreign markets and paving the way for export activities, without also enhancing technology and productivity to ensure sustainable benefits. In the absence of such sector policies, countries have been unable to promote linkages from FDI, and have not supported an environment for spillovers to occur. Incorporating investment incentives into regional integration agreements may attract some additional FDI, but does not ensure linkages and spillovers to generate sustainable benefits. If the EU really wants to promote growth-enhancing trade in sub-Saharan Africa, it needs to support countries in devising appropriate sector policies conducive to productivity gains and intra-regional trade. Agri-business offers the best potential if there is coordinated support to increasing agricultural production and promoting cross-border trade to provide the supply of inputs for successful processing activities. The particular crops and regions will be country specific, but the principle applies broadly across the region.

The New EU Trade, Growth and Development Agenda:

A Step Too Short

Sanoussi Bilal

The EC Communication on Trade, Growth and Development, and its endorsement by the EU Council, is a welcome European initiative. As a lead international trade actor and aid provider, the EU has much to say on how best to combine trade and development and foster policy coherence for development. Or it should! In this respect, the outcome is an archetype of the EU nowadays, in both its positive and its less appealing traits.

The European Commission (EC) brings together a breadth of content from across its different directorates. This leads to a relatively uncontroversial document that appears to draw on the main emerging consensus in the fields of trade and development policy and to tie in nicely a range of existing policies and agenda issues. This is no little achievement for any administration, let alone the EU. It is also encouraging to see greater prominence given to market force considerations, equity, ownership and sustainable development in addressing the nexus between trade, growth and development. In essence, the EU stresses, among other things:

- The pivotal role of the multilateral approach and the need to strengthen the WTO as well as to achieve some concrete results in the current round of negotiations (e.g. on trade facilitation, Non-Tariff-Barriers (NTBs), dispute settlement and free market access for Least Developed Countries (LDCs) in goods and improved access in services);
- The need for Europe to adopt a differentiated approach, focusing on the poorest countries – mainly LDCs and ‘other developing countries most in need’, as stressed by the Council;
- The importance of addressing behind-the-border issues and supporting domestic reforms, infrastructure development, productive capacity and the various governance dimensions crucial

to sustainable and inclusive growth, including the respect and promotion of human rights;

- The key role of the private sector – in particular small enterprises – and investment;
- The need for better targeted and more effective AfT;
- The need to contribute to sustainable development and promote a green economy approach, including through trade measures; and
- The importance of domestic ownership.

Hardly any controversial issue there!

Reflecting on the EU approach, there is a sense of a missed opportunity, not so much in terms of what the Communication says, but in the key strategic considerations it omits to address.

The EU fails to be more explicit in declaring its own (trade) interests and how it intends to reconcile these with its values and development agenda. In the current climate, whereby European economic growth and employment are also a key policy concern, seeking a win-win relationship on trade and development with its developing partners would seem natural. But, unlike emerging players, the EU remains stuck in a benevolent discourse on trade and development, which unfortunately may sound somewhat patronising to many of its partners.

While the EU focuses on the LDCs and ‘other countries most in need’ (without ever defining this latter category), it says very little about those countries next on the development ladder – the Low-Income Countries (LICs) and Middle-Income Countries (MICs). Yet it is for these countries that a comprehensive trade agenda embodied in a thorough development strategy could provide the most potential for equitable and sustainable growth.

The EU is also very keen on excluding emerging players, which it sees mainly as competitors, from the realm of its trade and development agenda. This may well be justified in terms of unilateral trade preferences and development assistance. However, by ignoring the potential for cooperation with emerging players such as Brazil, India and China, the EU may seem out of synch with the rapidly changing world economy and development landscape. South–South relations have increasingly prominent implications for the dynamics of EU engagement with its developing country partners on trade and development issues. The EU’s failure to offer any vision on this potential new dynamic may prove very counterproductive, from not only trade and development but also political and geostrategic perspectives.

In this context, the EU also fails to draw the most out of the critical role the private sector can play in fostering development. The Communication does propose a concrete package for small operators. Besides practical considerations on the operationalisation of such measures, for which the EU has no demonstrated comparative advantage, there is no strategic reflection on how much genuine demand there is from small operators in developing countries to enter into international markets when many of the constraints faced relate more to entering into local and national value chains. Given the weakness of business associations, in particular for small operators, in the poor countries most in need where the EU wants to focus its effort how can trade policy be used to encourage this level of integration into the world market? Moreover, the EU gives no proper consideration to the role its own international private sector can play in fostering development through trade and investment for inclusive and sustainable growth.

The EU also calls for a more strategic approach to its support to regional integration, notably by addressing regional integration in its political dialogue with developing countries and a greater focus on regions that show political will and have the capacity to deliver. This is very much in line with the tone of the EC during the ongoing mid-term review of the 10th European Development Fund (EDF) where serious cuts to the Regional Indicative Programmes are being announced. The EU is sadly silent on any specifics of its reviewed approach. To what extent will the EU adjust its support to regional integration, in which direction and to do what? And how can the EU revive its too often faltering political dialogue with its developing partners, better integrating a regional dimension? The EU falls short of spelling out any vision.

The issue is all the more pressing as efforts by the EU to combine a trade and regional integration approach, in particular through negotiations of comprehensive Free Trade Agreements (FTAs), has at times encountered

much resistance when it has not been outright unsuccessful, as with the Andean Community and in sub-Saharan Africa. The lack of reflection on the potential lessons of the Economic Partnership Agreement (EPA) negotiations with the ACP countries, some of which have been dragging on for almost 10 years now, is staggering. Failure to conclude agreements with a regional dimension could lead to a serious disruption, if not a break-up, of the regional integration dynamics in parts of Africa. While the EU reiterates the principles of asymmetry and regional dimensions, it does not reflect on its past failures and successes (as in Central America and the Caribbean) to articulate a new vision that could not only help to unlock some of the EPA negotiations but also foster a better tailored approach in other regions, such as with the Association of Southeast Asian Nations (ASEAN).

As for the promotion of core values – such as good governance, social, labour and human rights – the EU does not spell out clearly how these can best be articulated in its trade agenda. Pressing issues include coherence between the Generalised System of Preferences (GSP/GSP+) and other FTAs, implementation and remedies available for such principles, their effectiveness in supporting domestic reforms in partner countries and how best to reconcile such basic objectives with the principle of ownership. Such questions will be most acute in the southern Mediterranean countries, where the EU is committed to a ‘more for more’ approach following the Arab Spring, comprising more aid, market access and a migration facility for its partners engaged in more democratic and better governance reforms (EC, 2011a; 2011b). The articulation of such principles in the context of an equal partnership towards ‘comprehensive and deep free trade agreement’ will be challenging, in particular if the EU does not want to be seen as driving an external agenda forced on fragile countries. The priority of these countries following the Arab Spring is to reinvent themselves, establish their own new approaches to governance and development and deliver promptly on the Arab Spring promises of economic recovery, job creation and poverty alleviation. Most surprisingly, the Communication makes only scant remarks, as in passing, on these enormous challenges at the EU’s doorstep.

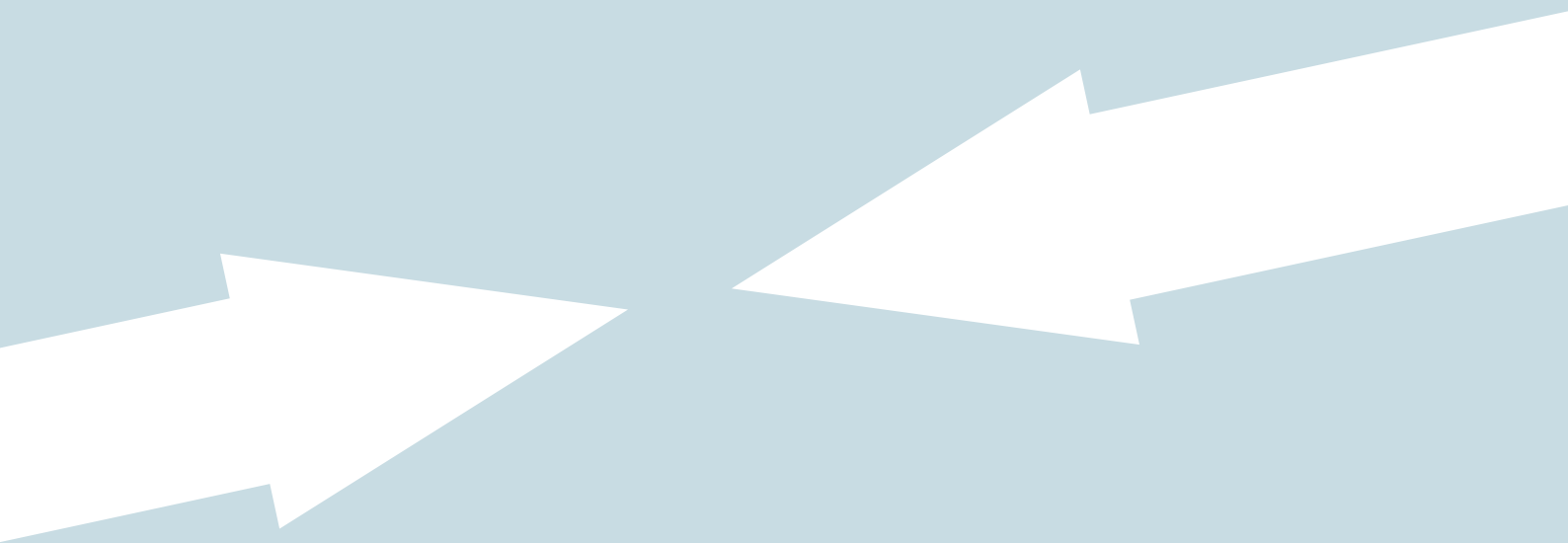
If the EU is to become a more meaningful international actor in a rapidly changing global context and live up to the promise of the Lisbon Treaty of an integrated approach to the trade and development dimensions in EU external action, it will have to be more ambitious in addressing the numerous new economic, political and geostrategic challenges confronting it. The Communication does not prevent such developments, but does little to stimulate them.

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Trade-related Instruments to Support Trade, Investment and Growth



The Proposed New GSP: Turning Away from Multilateralism

Christopher Stevens

Multilateral and regional trade preferences have gone hand in hand ...

For over four decades, there have been two dimensions on which to compare EU trade policies towards developing countries: reciprocal or non-reciprocal; and bilateral or multilateral. All have offered partners better access to the EU market than the basic most-favoured nation (MFN) treatment that is the right of all WTO members. But reciprocal (unlike non-reciprocal) agreements have required a *quid pro quo*, and bilateral or regional deals have not been available to all developing countries.

In the most recent decade, there has been a contradictory set of changes on the two dimensions. On the one hand, there has been a sharp shift from non-reciprocal to reciprocal bilateral/regional agreements as, for example, the Mediterranean accords have been replaced by Free Trade Agreements (FTAs) and the trade provisions of the Cotonou Partnership Agreement for African, Caribbean and Pacific (ACP) states have been replaced by Economic Partnership Agreements (EPAs).

On the other hand, the non-reciprocal, multilateral Generalised System of Preferences (GSP) has been made much more liberal. Beginning life as the poor relation of EU development trade policy, covering fewer products with often higher tariffs than the bilateral/reciprocal accords (Stevens, 1981), the GSP has been transformed during the past decade by the Everything But Arms (EBA) regime for Least Developed Countries (LDCs) and the GSP+. The result: a basic minimum available to all developing World Trade Organisation (WTO) members, giving them a competitive advantage over the Organisation for Economic Co-operation and Development (OECD) suppliers without an FTA with Europe; and more liberal access for two sub-groups deemed to have special needs (Stevens et al., 2011).

... Until now

The EU is considering the new GSP regime that will apply from 2014 and, while the proposal does not detract from either of the special regimes, it removes the commitment to all developing WTO members. All Upper-Middle-Income Countries (UMICs) will be excluded from the GSP, even for products where they are not very competitive.

The justification for the change is that the UMICs are sufficiently well integrated into the world economy not to 'need' the GSP; and it will ease pressure on less competitive developing countries and hence will 'focus the GSP preferences on the countries most in need' (European Commission, 2011).

Neither claim stands up well to examination. UMICs are not a very close proxy for 'the most competitive developing countries'. Under the new regime, China will remain in the GSP but Cuba will be excluded; Indonesia and Thailand will remain in, but Gabon and Namibia will be out. Moreover, the GSP already includes a mechanism to remove preferences from any non-LDC on any product in which it is particularly competitive. This 'product graduation' will also be changed under the new GSP.

Nor are very poor countries likely to benefit – they tend not to be competitors in goods that will be affected by the removal of UMICs and the change to product graduation. Overseas Development Institute (ODI) research has shown that the most likely beneficiaries will often be high-income states which export the largest number of the affected goods (see Figure 1 overleaf).

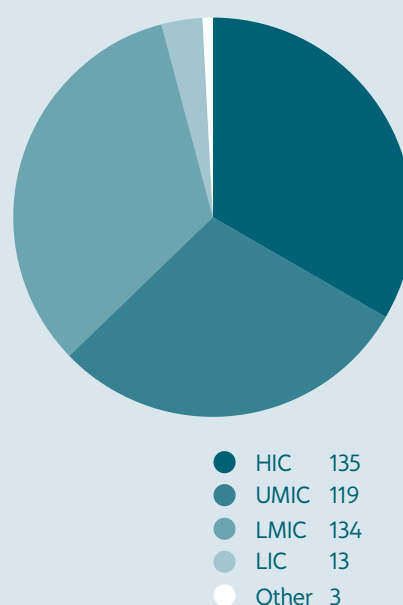
The effect: protectionism or a post-Doha policy shift?

One perspective on the proposed changes is that they reflect a retreat into protectionism but, if so, it is only a small step. The GSP already allows the EU to exclude the most competitive suppliers on a product-by-product basis; many UMICs have negotiated (or are negotiating) FTAs with the EU; and many of their most important exports receive no preference under the basic GSP regime. ‘Small earthquake; not many killed.’

From another perspective, though, the expulsion of UMICs may have a more substantial impact, especially when seen against the background of EU arguments that the emerging economies should offer more to unblock the Doha Development Round. The GSP is justified in the WTO under the Enabling Clause that allows developed countries to offer preferences to *all* developing countries. It also allows discrimination by developed countries in favour of sub-groups of developing countries, but only if they share a widely recognised ‘development, financial [or] trade need’, if the differentiation is relevant to meeting this need and if it is clearly related to trade needs (WTO, 2004: Paragraph 164). A simple income-related cut-off that keeps in China but excludes Namibia is hard to square with this requirement.

What the new GSP does, therefore, is redefine what a developing country is within the WTO. UMICs will still be eligible for preferential access to the EU market (and compete head on with the poorest developing countries), but only if they agree FTAs, not by virtue of their WTO status as developing countries. This may not be the main intention of the change, but it is hard not to see it as a milestone on an EU path away from the centrality of a multilateral set of trade rules to protect all players (including the weakest states which WTO supporters would argue need it the most) towards a set of plurilateral arrangements within which each of the biggest economies is able to set the agenda more easily.

Figure 1: Most important sources of EU imports of key graduated products (shares)



Note: Income groups based on World Bank classifications at January 2011. ‘Other’ = countries not listed by the World Bank (other than Taiwan, which is included in high-income countries, HICs) and countries not specified in the trade statistics. LMIC = lower-middle-income country.

Source: Stevens et al. (2011).

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Trade and Development:

Some Implications for EU Trade Policy

Ken Heydon

EU priorities

The EC Communication of March 2012 on Trade, Growth and Development (henceforth the Communication) contains many elements that have the potential to help to foster economic development in developing countries, in particular:

- Reform of the Generalised System of Preferences (GSP), including by reviewing eligibility criteria and graduation mechanisms, to ensure preferences benefit those countries most in need;
- Better targeted Aid for Trade (Aft), with improved programming and delivery;
- The pursuit of comprehensive Free Trade Agreements (FTAs) via Economic Partnership Agreement (EPA) negotiations, with the option for developing countries to open partially and gradually;
- An absolute priority for getting multilateral trade negotiations to work more effectively for development, including through a package for Least Developed Countries (LDCs) and an agreement on trade facilitation.

The extent to which these objectives translate into an effective stimulus to development will depend on four things: (1) avoiding the pitfalls of departures from the pursuit of open markets; (2) fostering a holistic approach to trade policy in developing countries; (3) improving developing country access to WTO dispute settlement; and (4) addressing particular aspects of EU trade policy that may run counter to its development aspirations.

The pitfalls of departure from open markets

Trade liberalisation – particularly one's own liberalisation – and the strengthening of trade rules help stimulate innovation and hence growth. There are five channels: increased competition resulting from market opening; the transfer of skills and technology embodied in trade; opportunities through economies of scale to better recoup research and development (R&D) investments over a larger quantity of sales; encouraging the global fragmentation of production processes; and the protection of IPRs.

Empirical evidence thus suggests that greater openness is an important element explaining growth performance and that market opening has been a central feature of successful development. No country has developed successfully by closing itself off from the rest of the world.

It follows that, while the flexibilities and 'policy space' offered by special and differential treatment can help developing countries to cope with the structural adjustment associated with trade liberalisation, such provisions need to be handled with care.

The Communication rightly points to the experience of a number of South and Central American countries which have undertaken structural reform as part of agreements with the EU rather than relying on unilateral trade preferences. Undue reliance on preferences risks locking countries into patterns of production that do not necessarily correspond to their underlying comparative advantage. Concern about preference erosion also acts as a brake on multilateral trade liberalisation, recalling that, for all but a handful of countries, the gains from widespread most-favoured nation (MFN) market opening will more than offset the welfare losses arising from preference erosion.¹

Flexibilities allowing for gradual market opening also need careful application. Policies that seek to impede or delay market opening reduce the opportunities to reap the gains from own liberalisation, while at the same time leading to a two-tier trading system whereby, for example, Organisation for Economic Co-operation and Development (OECD) countries' tariffs on developing country exports are higher than those on advanced country exports.

The provision of financial support for developing countries, including through AfT, is a necessary feature of the trading system, but this too needs to be handled with care if the pursuit of liberalisation and reform is not to be held hostage to the provision of technical and financial assistance.

The EU will thus need to be careful that its trade and development policies do not serve to discourage developing countries from opening their own markets. At the same time, opportunities might be taken to increase the scope of EU preferential benefits in order to reduce the *locking-in risk*.

Putting trade policy in a broader framework

There will, however, be winners and losers from market opening – and the evidence is mixed as to whether trade liberalisation in itself reduces poverty and income inequality. Drawing benefits from greater market openness will work only in a broad policy environment that allows labour and capital to move from declining to expanding areas of activity, and dynamic gains from trade will be stronger when backed by sound policies dealing with competition, education and the regulation of labour and financial markets. As pointed out in the Communication, the ability to graduate from LDC status depends on good macroeconomic management and governance as well as on progressive trade opening and integration into the world economy.

The principle, drawn from Jan Tinbergen, that multiple goals call for multiple policies applies particularly to four acute problems facing many poor and vulnerable developing countries. Reduced reliance on tariffs for revenue calls for fiscal reform and a widening of the tax base. Reduced reliance on trade preferences calls for broad-based economic reform that encourages the diversification of production and exports. Maintaining stable production for exports calls for institution building and the rule of law. And deficiencies in human capital need to be met by sustained programmes of training and education in order to foster a better match between the skills base and labour market needs.

The success of EU trade policy in helping to foster development will depend critically on its ability to help promote a holistic approach to trade policy within developing countries.

Improving developing country access to WTO dispute settlement

The EU is right to give absolute priority to *multilateral* negotiations; Preferential Trade Agreements (PTAs), including EPAs, are inevitably second best. It must be recognised, however, that prospects for the Doha Development Agenda (DDA) – as a Single Undertaking – are at best uncertain and that, for the foreseeable future, the WTO will proceed through litigation rather than legislation. It is therefore a matter of some concern that developing country engagement in WTO dispute settlement is very modest. Only six countries account for 60% of developing country involvement in dispute settlement, the vast majority of developing countries are absent from the process and to date the only LDC to initiate consultations is Bangladesh.

A principal reason for limited developing country participation in dispute settlement is their inability to actually identify the trade barrier that could be the subject of a dispute. EU help in fostering this capacity would greatly enhance the ability of developing countries to benefit from the multilateral trading system.

Addressing some specific aspects of EU trade policy

In terms of the effectiveness of specific aspects of EU trade and development policy:

- Does scope exist for more consistent application of Member States' AfT strategies?
- Is there evidence that the new rules of origin have affected utilisation rates of EU unilateral preferences?
- And is analysis available of the beneficial effects on developing country EPA partners of regulatory harmonisation, or of the potentially negative effects of trade diversion associated with EPA preferences?

And, more broadly, to what extent are EU trade and development policies being frustrated or compromised by persisting dispersion in the EU's MFN tariff, by EU anti-dumping action, by EU regulatory practices or by the European public procurement regime?

All of these questions arise from the EU's latest Trade Policy Review. They suggest EU goals in the area of trade and development may, in certain areas, be frustrated by the actual practice of EU policy. Were that policy to be captured by the pursuit of green protectionism, these internal tensions would become even more acute.

Footnotes

1. As pointed out by the EC Staff Working Paper, loss from preference erosion is also relatively small because preference margins are rather modest and preferences underused.

Economic Partnership Agreements:

The End of the Beginning

Christopher Stevens

The trouble with trade negotiations is that they are conducted by trade officials not trade economists! This means, at least from the perspective of the latter, they are treated as a mercantilist exchange of ‘concessions’ – and that the hard issues are left right until the end, making impact assessment problematic.

Each side normally seeks as few changes as possible to its own policy (in the form of cuts to tariff or non-tariff import barriers and new trade rules) while pressing for the greatest change to its partners’ policies. The changes that would make the maximum impact on the domestic market are usually resisted most energetically and, until almost the very end, both sides in the poker game insist they will not happen. If, despite this, they are changed, it is not only agreed in a rush right at the end but often subject to a host of caveats – including, often, a significant delay in implementation (of up to 25 years in the case of Economic Partnership Agreements (EPAs)).

So any impact assessment undertaken sufficiently early to have an effect on the outcome has to be done in ignorance of detail on the changes most likely to produce a relatively large economic impact. A consequence is that the actual impact will tend to become apparent only over time – often many years – as an agreement is implemented (and after so much else has happened that the impact of the trade agreement itself may be hard to identify).

The end of the EU’s autonomous ACP preferences

For EPAs, this period of little or no major change has been extended – as a consequence of the dynamics of negotiations between trade officials. Begun formally in 2002, the EPA negotiations dragged on with little progress as the 2007 deadline set by the EC steadily approached. As 2007 began, it was clear that a set of

full EPAs was unlikely to be completed by the end of the year (as too much technical detail remained to be addressed, let alone agreed), but the EC rebutted all calls for an extension. This was partly because the World Trade Organization (WTO) waiver justifying the pre-EPA trade Cotonou preferences expired at the end of the year, and partly in order to maintain pressure on the Africa, Caribbean and Pacific (ACP) negotiators.

But reality broke through during the last quarter when, first, the EC agreed that only interim EPAs, covering only goods, needed to be completed by the deadline and, then, when even this appeared unachievable, introduced an autonomous regulation that extended pre-existing preferences to all ACP countries that were still negotiating in good faith. As a result, there were very few casualties from the EPA process in 2008. Most of the countries that walked away from the negotiations were Least Developed Countries (LDCs) that remain eligible under the Everything But Arms (EBA) tranche of the Generalised System of Preferences (GSP) for preferences that are very similar to those that they had enjoyed previously under Cotonou. The small number of non-LDC states that walked away were countries like Nigeria and Gabon which exported few goods to the EU that face high tariffs.

This stay of execution is set to end at the start of 2014 (when the EU’s new GSP is expected also to kick in), see essay number 6, because the EC has proposed to remove autonomous preferences from any state that has failed to sign and ratify an EPA by this date – although they can be reinstated ‘as soon as they have taken the necessary steps towards ratification of their respective Agreements, and pending their entry into force’ (EC 2011). Eighteen ACP states are affected.¹ The imposition of this deadline is likely to force the pace of negotiations so that some – perhaps most – of the states sign (in those cases where they have not yet done so) and ratify, although some may not.

Non-trivial trade policy changes will start to happen ...

Because of delays in implementation by EPA signatories and the extension of the negotiating period for others, the impact of EPAs thus far has been underwhelming. However, this is set to change in 2014 when the first non-trivial changes will happen if some of the non-LDCs on the EC list fail to ratify and experience a significant increase in the tariffs they pay on their exports to the EU. The countries and products that are vulnerable to tariff hikes are listed in a 2007 report by ODI.

Other non-trivial changes will follow in short order. For the Caribbean Forum (CARIFORUM), some big changes are due in 2015-2017 when the EPA rules on 'para tariffs' kick in. These are taxes on imports other than tariffs, and the Caribbean region boasts a particularly impressive array. They range from special taxes that apply only to imports, to importer fees that greatly exceed the costs of providing the services delivered. Under the EPA (signed in 2008), these must be eliminated between Years 7 (2014) and 10. Also, over the coming years, most of the timetables included in the draft and interim EPAs of 2008 require that some significant tariffs start being removed.

... Which may put the ball in the EU's court

The EPA negotiations exhibited an unusually asymmetrical power relationship. The EU was able to offer few improvements in market access over Cotonou simply because most imports from the ACP already entered its market duty free. In return for the major changes it sought to ACP trade policy, it could offer only a negative: that it would not impose new tariffs on ACP exports and thus hobble existing trade.

Once this threat of new tariffs has been lifted by EPA signature and ratification, though, the asymmetry reverses direction. It is the ACP that must decide whether, how (and within limits) when to apply the changes to which it has agreed. In many of the more contentious areas, there is some ambiguity over what is required. It is for the ACP state, for example, to decide in the first instance whether a particular tax or charge qualifies as a para tariff that must be removed. Only if the EU takes a different view can the matter be tested – and only if it refers the matter to arbitration will an enforceable 'independent' view be expressed. Although the precise provisions on dispute settlement vary between EPAs, they all share two features. First, one arbitrator is nominated independently by the EU and one by the ACP (and they jointly select a third, who chairs). So it is far from certain that the ACP will 'lose' all disputes. Second, if the ACP does lose and fails to apply the measure it is adjudged to have omitted, the maximum penalty is the EU's removal of equivalent trade concessions. Even if the ACP and EU take the same view, administrative constraints may delay implementation – as has happened in CARIFORUM, the only full EPA signed and ratified by (almost all) parties.

In other words, the EU is likely over the coming years to face a series of 'challenges' in the form of actions (or inactions) by its ACP EPA partners that fail to apply wholly or in part the changes it believes have been agreed. Not all such challenges will even be noticed; not all those noticed will be subject to EU action. When action is taken, the EU will not always prevail. And, even when it does, the ACP party may not comply. Such tussles are bound to spill over to some extent into broader development policy. Negotiating the EPAs soured other aspects of EU-ACP development policy. Implementing the EPAs may be worse.

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Footnotes

1. Botswana, Burundi, Cameroon, Comoros, Côte d'Ivoire, Fiji, Ghana, Haiti, Kenya, Lesotho, Mozambique, Namibia, Rwanda, Swaziland, Tanzania, Uganda, Zambia and Zimbabwe.

The Need to Reconcile Trade and Climate Change Regimes for Development

Jodie Keane

Although climate change is a new trade issue and a formidable challenge that all countries must address, the new European Commission (EC) Communication on Trade, Growth and Development fails to articulate the links between its climate change mitigation policies and its trade and development policy for late industrialisers, including the Least Developed Countries (LDCs). This is despite the development of a climate change mitigation policy that does make explicit reference to LDCs. This raises the issue of policy coherence related to maintaining principles of special and differential treatment between trade and climate change regimes. Other issues are also raised related to country differentiation. Given new indicators of vulnerability related to the physical as well as regulatory effects of climate change on different types of developing countries, the EU must integrate climate change within its trade and development strategy for the coming decades.

Despite the outcomes from the latest round of negotiations, the 17th Conference of the Parties (COP17), held in 2011, in relation to a new global climate change agreement, which includes a second commitment period for the Kyoto Protocol post-2012, there remains a considerable degree of ambiguity in terms of potential conflict areas between trade and climate change regimes. Policymakers need to address the regulatory gaps and potential clashes between the trade and climate change regimes, but also to develop possible synergies between them. The importance of doing this for most late industrialisers is amplified because of their inherent structural characteristics: the limited scale of domestic economies because of small economic as well as geographic size enhances the role of trade as a contributor to growth. This means ensuring a new climate change regime facilitates rather than hinders the process of export diversification, and structural change takes on an added urgency.

The outcome from the COP17 negotiations – the Durban Platform for Enhanced Action – consists of 36 separate decision texts (19 COP decision texts and 17 Kyoto Protocol texts in addition to the Durban Platform). These decision texts cover the continuation of the Kyoto Protocol and the setting-up of the new Green Climate Fund, as the two major outcomes from COP17 (in addition to the Durban Platform agreement itself). Essentially, the COP17 outcome consists of a commitment to agree a new international agreement with legal force under the United Nations Framework Convention on Climate Change (UNFCCC) in the future, but this is not guaranteed.

This uncertainty is not conducive to the design of trade and development strategies that need to adapt to the new trade agenda, which includes climate change. Given that most LDCs to date (many of them in sub-Saharan Africa) have not been able to tap into existing dynamic production networks is clearly of concern. The export profiles of LDCs are typically characterised by high degrees of concentration, with only a few tariff lines accounting for the bulk of exports. This profile makes them most vulnerable to demand-side volatility and other shocks, including climatic ones.

Although there have been successes, the ability of many Low-Income Countries (LICs) to tap into the modern export sector has been limited, and remains at best fragile. The successful experience of the Newly Industrialised Countries (NICs) was used in the 1980s to justify recommendations that other late industrialisers move away from the substitution of imported products for domestic production towards outward orientation in order to benefit from external economies through trade. However, the prospects for external trade have changed, and many of the routes used to industrialise in the past may no longer be viable for late industrialisers today. Efforts to diversify exports by this group of countries have not been totally successful, even under favourable economic conditions and in the absence of climate change.

Changing patterns of demand and supply, given the impact of the Asian drivers on global trade patterns, have to some extent been accelerated by the impacts of the global financial crisis, but they also come at a time of changing North–South trade relations more generally. This includes the proliferation of Regional Trade Agreements (RTAs), in addition to reform of the EU's Generalised System of Preferences (GSP). Our research suggests the significant preference margins available to non-graduates of the EU's GSP once reform has been implemented will remain on only a rather limited basket of natural resource-based exports, some of which may be highly vulnerable to the physical effects of climate change (e.g. fisheries), as well as the regulatory effects of policies to mitigate it (e.g. carbon labelling schemes).

That existing trade instruments did not facilitate structural change in the previous trade environment suggests reform is needed in order to adapt to the new trade environment, which includes addressing climate change. The EU is currently the major export partner for LICs (and LDCs). Therefore, the climate change mitigation policies it implements will have the largest effects on them relative to other developing country partners at the current time. Fortunately, the EC has stated that it will exempt LDCs from punitive measures such as border tax adjustments (BTAs) and enhance market access to LDCs in its Emissions Trading Scheme (ETS) (through excluding other developing countries).¹ This arguably provides LDCs with a unique opportunity to tap into the new trade opportunities that may arise from climate change mitigation policies implemented in the EU. However, the increased complexity of the EU ETS, as has become apparent in recent months (as individual members begin to establish their own schemes), clearly raises cause for concern.

The ETS is the largest purchaser of Certified Emissions Reductions (CERs) obtained from the Clean Development Mechanism (CDM) established under the first commitment period of the Kyoto Protocol. It has clearly stated that it does not consider the outcomes of COP17 to be a new international agreement. Further to the outcomes of COP17, the EU's ETS will continue to purchase CERs from the CDM from 2013 onwards. However, a number of changes have been made to the EU's ETS, including the inclusion of the aviation industry from 2012 and the limitation of the market for CERs to LDCs from 2013. The United Kingdom (UK), Poland and Germany have also decided to set up their own national schemes.

There are concerns that the multiple platforms could make the EU's ETS more complex, costly and insecure. As other developing countries begin to introduce emissions reduction targets and related command and control mechanisms such as their own ETS (primarily in response to international pressure and the threat of punitive measures), these could have subsequent knock-on effects on LIC importers of products covered by such measures. The disjuncture that became apparent between supporters of the Kyoto Protocol and the Long-term Cooperative Action (LCA) track of negotiation at COP16 is intended to be rectified by 2020. But some of the continued obstacles in LCA negotiations include a failure to provide significant additional clarity and positive incentives on CERs obtained from Reducing Emissions from Deforestation and Forest Degradation (REDD+) schemes.

These policy developments mean the potential trade effects of any new international agreement are difficult to assess and will be highly country, product and market specific. This is because changes in trade patterns will be driven both by the effects of climate change on productive structures but also by responses to it by private sector actors and governments through the development of regulatory measures to mitigate further temperature increases. The physical and regulatory effects of climate change will therefore be highly product and value chain specific. The extent to which such measures may support or undermine efforts to diversify productive structures through the realisation of export-oriented growth strategies by late industrialisers therefore deserves much more attention by the EU as it develops its trade and development strategy for the coming decade and as it implements its climate change mitigation policy (see Keane, 2011).

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Footnotes

1. As referred to in Article 11a (7) of the EU ETS Directive and Article 5(3) of the Effort Sharing Decision, see http://ec.europa.eu/clima/news/docs/additional_qa_06_01_2011_en.pdf. For information on the LDC limitation to the EU's ETS from 2013, see EC (2011).

Natural Resources and Sustainable Growth:

A 21st Century Trade Issue

Dirk Willem te Velde

The global community is putting unsustainable pressures on the world's resources. Some suggest we are reaching or transgressing planetary boundaries in areas such as carbon dioxide emissions, biodiversity losses and freshwater availability. There are increasingly concerns in relation to scarcity, although we need to qualify this. For example, there are plenty of energy sources (coal, gas) but carbon space is scarce, so we are looking increasingly for renewable energy sources. There is plenty of water in some countries, but there is a lack of water development in many poor countries and physical scarcity in others, and globally there will be a gap of 40% between supply and demand by 2030. There is still unexploited land, but globally there are increasingly pressures on land use.

It may still be a long time before crucial raw materials and rare earth metals (the European Union (EU) has identified 14 of them) run out, but the concern is that many of them are concentrated in sometimes weakly governed locations (antimony, fluorspar, gallium, germanium, graphite, indium, magnesium, rare earths and tungsten in China; platinum group metals in Russia, cobalt and tantalum in the Democratic Republic of Congo; and niobium and tantalum in Brazil). Moreover, if targets on renewable energy are to be met, this increases demand for rare earth metals faster than their supply. Wind turbines and electric vehicles rely on dysprosium and neodymium to make the magnets essential for their generators and motors. All of this means sustainable growth and hence future development is under pressure.

The European Commission (EC) Communication recalls the Raw Materials Initiative and mentions a set of EU trade-related regulations to promote sustainable management of timber and fish. But there is little

further discussion of natural resources. There is a bit more under the heading of response to crises: 'Poor developing countries also face other global challenges, such as securing sufficient, reliable energy supplies or adapting their economic systems to changing global climate conditions and threats to their natural resource base' and 'World Trade Organisation (WTO) members will need to pay more attention to these major issues in the coming years. Effective cooperation with emerging countries will be essential.' And, in the section linking natural resources to conflict: 'In parallel we will continue to cooperate with and provide support to developing country partners on sustainable mining, geological knowledge and good governance in natural resources management.' The Communication may not be considering the full scale of the natural resource challenge in the coming decade. A much more strategic approach will be required.

What is the EU doing on natural resource management, especially in relation to raw materials? It has put in place: (1) internal policies such as the EU Raw Materials Initiative; (2) bilateral and global trade policies on natural resources; and (3) development cooperation measures. First, the Raw Materials Initiative discusses 41 essential raw materials, and points to shortages of 14 key raw materials used in making cell phones, solar power cells, batteries and other electronics: antimony, beryllium, cobalt, fluorspar, gallium, germanium, graphite, indium, magnesium, niobium, platinum group metals, rare earths, tantalum and tungsten. The demand for these is expected to increase. Communications in 2008 and 2001 relating to the initiative are based on three pillars: (1) access to raw materials globally under undistorted conditions (e.g. development policy and trade strategy); (2) a sustainable supply from European resources; and (3) reduced consumption of raw materials and increased efficiency.

Second, the EU has introduced trade provisions. EU unilateral trade provisions include Everything But Arms (EBA), the Generalised System of Preferences (GSP) and the GSP+. The GSP+ offers additional tariff preferences to 16 countries to support vulnerable developing countries in the implementation of international conventions in the areas of sustainable development and good governance. Bilateral trade agreements also include provisions on natural resources. The full EPA with Economic Partnership Agreement (EPA) with the Caribbean Forum (CARIFORUM) and the interim EPAs signed by many (but not all) Africa, Caribbean and Pacific (ACP) countries and regions seek to ban export restrictions and export taxes, subject to temporary and exceptional circumstances such as critical shortages of foodstuffs, protection of infant industries or protection of the environment, in a way that goes beyond WTO obligations. This has been a source of friction for African trade ministers; for example, Namibia signed the Southern African Development Community (SADC) interim EPA only after reserving the right not to implement the agreement unless the provision on export taxes was lifted. EU agreements with Chile, Korea and Mexico also ban export restrictions. Furthermore, the EU has successfully challenged export restrictions by China at the WTO: China accounts for over 90% of the world's production of rare earth metals.

Third, on development cooperation, the EU published the Agenda for Change in 2011, which emphasises: (1) good governance, including to manage natural resources; and (2) the importance of inclusive and sustainable growth.

This quick review suggests the EU has begun to consider access to raw materials. It has tried to secure access of raw materials by asking developing countries to ban export restrictions and taxes. Export restrictions and taxes are not the most efficient way, however, of diversifying LIC industries; it is better to design appropriate corporation and loyalty tax schemes and put in place good economic policies to benefit from the exploitation of natural resources. Moreover, Least Developed Countries (LICs) themselves can be major victims of export restrictions. But African/LIC negotiators themselves will need to be persuaded by these arguments, and they have so far been more interested in retaining policy space. Until then, it is important to pursue the multilateral route.

What is notable, however, is that much less attention has gone to the increasing scarcity of water and land, which is essential for food security, energy production and much (if not everything) else. This will become increasingly important in the coming decade. The challenges are different, as land and water are not as easily traded as rare earth metals, so what is important is that countries can access land and water virtually and via trade. Countries that lack access to water and land (and hence have large food and energy import bills) will need to retain access through (virtual) trade. The Communication rightly identifies trade and food security as an issue, but what is the operational follow-up?

The natural resources agenda is more general, and the Communication on Trade, Growth and Development needs to acknowledge this. Trade is indeed a solution to increasing scarcity of natural resources, but efforts to reduce consumption, increase efficiency and augment the sustainable supply of natural resources will all be important to promote growth and development. A crucial part of this is promoting effective governance of natural resources worldwide: well-managed resources can contribute to sustainable growth. It is not immediately clear how much trade and investment provisions (the Extractive Industries Transparency Initiative (EITI), Forest Law Enforcement, Governance and Trade (FLEGT), etc.) can help with this – good governance is a long-term process that needs to build on domestic institutions and policies (and there is large heterogeneity; compare, e.g., the experiences of Botswana and Nigeria). The AU African Mining Vision is the beginning of a process. Access to (virtual) natural resources will be a key feature of trade relationships in the future. The EC Communication pays too little attention to the operational and strategic aspects of this 21st century trade issue.

Policy Incoherence: Where is the CAP in the New EC Communication

Nicola Cantore

The EC Communication on Trade, Growth and Development contains many good intentions to encourage growth in developing countries. The paragraph on 'What Europe can offer' provides some details of the European Union's (EU) policy directions, which can be summarised under six broad pillars: (1) more focused preferences; (2) better targeted Aft; (3) complementary instruments boosting FDI; (4) comprehensive and modulated bilateral/regional agreements; (5) a values-based trade agenda to promote sustainable development; and (6) helping developing countries to improve resilience to crisis.

The introduction of the Communication contains a reference to policy coherence for development (PCD), and argues that trade and investment policies could help in the development and integration of economies in the world economy. It is surprising to see no mention of other EU policies such as the Common Agricultural policy (CAP) which nonetheless affect developing country growth and trade patterns.

The Overseas Development Institute (ODI) is currently examining the impact of existing CAP instruments and post-2013 reform on developing countries. This section compares the policy directions provided by the EU Communication with these research findings. As discussed in Annex XII of the EU CAP reform agricultural policy impact assessment, it is evident that the EU endorses the Policy Coherence for Development (PCD) in agricultural policies.

The main findings arising from our research can be summarised as follows:

1. Current CAP instruments harm developing countries. Instruments such as direct payments and export subsidies aimed at boosting the

production and income of EU farmers tend to reduce world prices and the attractiveness of the European market for developing countries. European import tariffs represent a further market distortion penalising competitive farmers outside the EU who cannot sell products to the European market because import prices in the EU are kept artificially high by trade policies.

2. The proposed post-2013 quota abolition in the sugar sector will induce EU farmers to increase production and will reduce world prices by penalising farmers in developing countries. A recent LMC International and ODI report (2011) estimates that the EU quota abolition in African, Caribbean and Pacific (ACP) countries could lead to an additional 200,000 poor people. Other proposed reforms, such as the redistribution of direct payments across EU Member States, seem not to have a big impact on developing countries.
3. Policies attempting to isolate domestic markets from the fluctuations of the world market price (such as the CAP) may further contribute to exacerbating world price volatility (Cantore et al., 2012a).
4. Proposals to green the CAP, when implemented in full, may represent an interesting trade opportunity for developing countries. Cantore (2012) suggests that greening measures for many commodities reduce the area harvested by European farmers. Management practices such as set-aside oblige farmers to reduce production. In the short to medium term, the reduction in production raises price-incentivising exports of farmers in developing countries (which may be using less intense farming production techniques). This effect is in addition to the environmental gains in terms of lower greenhouse gas emissions and the

avoidance of climate change damage, from which developing countries would also benefit in terms of development and growth.

The EC Communication on Trade, Growth and Development should therefore consider the following directions:

1. It should aim for a liberalised agriculture market in Europe abolishing subsidies for EU farmers which create market distortions. Funds diverted from support to EU farmers could be used to implement (agricultural) development programmes in the EU and developing countries consistently with the EU's PCD. In this way, the EU could meet its stated objective of meeting food security more efficiently than by supporting EU farmers.
2. Such a policy shift would require an unambiguous declaration by the EU that its priority for food security will not be achieved by paying subsidies to EU farmers but rather sustainable agriculture worldwide. Unfortunately, the current EU post-2013 CAP reform does not firmly propose a reduction of distortive agricultural policies, but in the multiannual financial framework, it is still possible to reduce spending on the CAP heading and allocate it towards other headings which can better achieve stated objectives.
3. Full compensation is necessary for developing countries in cases where EU policies harm developing country exports and growth. Losers from the EU sugar quota abolition in ACP countries would deserve compensation for short-term losses even though in the medium and long terms, quota abolition could bring benefits in terms of a reduction in price volatility and market distortions.

4. As greening helps in dealing with challenging global changes and reducing the risk of natural disasters in developing countries (declared in the EC Communication itself as a priority), European governments should work to endorse the greening proposals contained in the EC reform proposal. Unfortunately, in December, many European governments did not endorse these.

We note that the EC Communication on Trade, Growth and Development does not even mention the CAP. Of course, EU agricultural policies fall under the Directorate-General for Agriculture and Rural Development, but in the spirit of PCD, the CAP should be discussed.

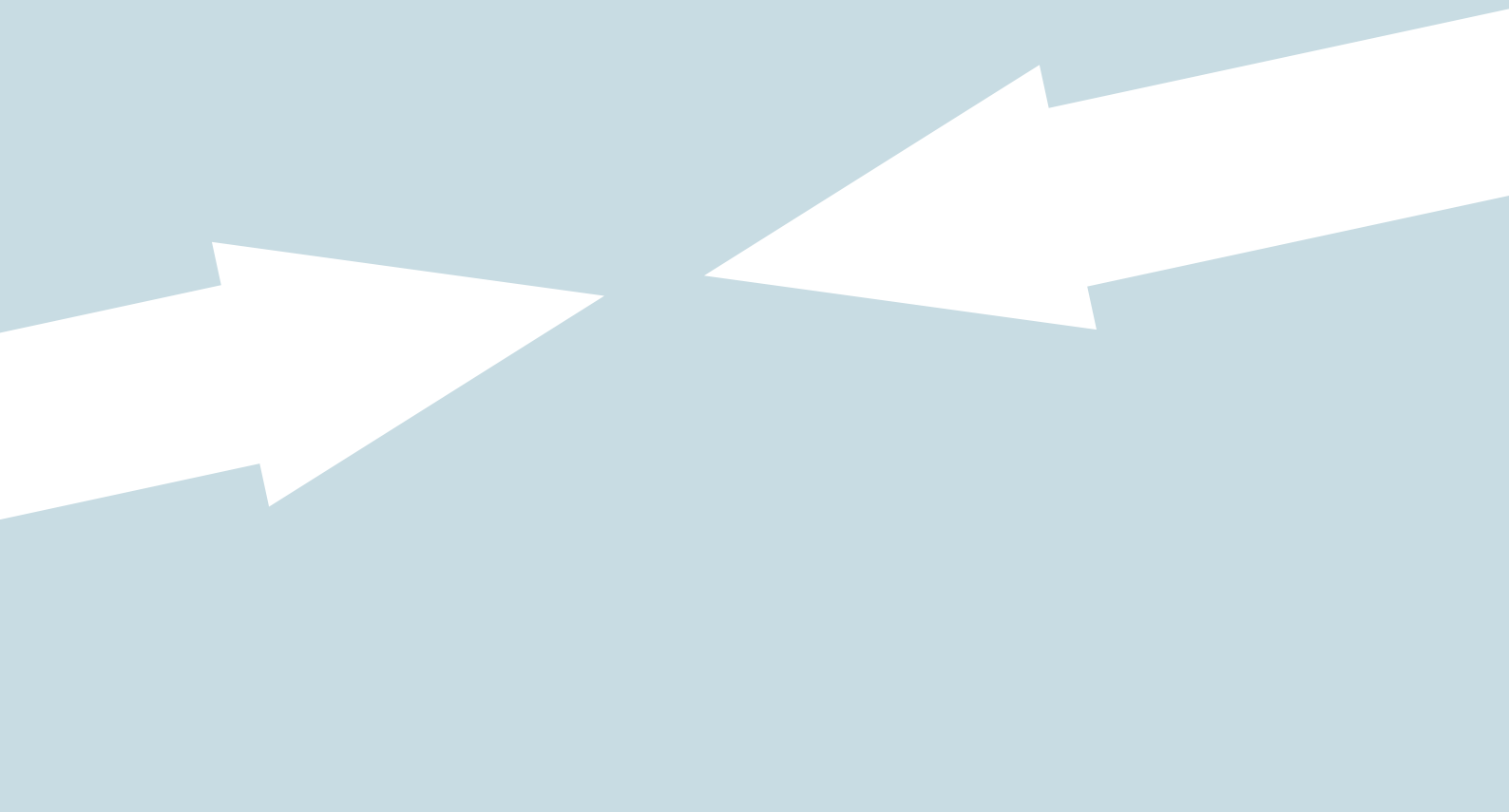
For example, the EC indicates the elimination of import and non-import tariffs only for goods and services which may deliver environmental benefits, and not for all commodities. The EC Communication calls for 'better assessing the impact of trade initiatives on the EU and its trading partners, including developing countries', but it is silent on compensation mechanisms for developing countries in the case of EU policies damaging them. The EU is still some way from reaching real PCD.

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Other Instruments to Support Trade, Investment and Growth



The EC Communication on Trade, Growth and Development:

A Targeted Approach to Promoting Aid for Trade Effectiveness

Yurendra Basnett

Aid for Trade (AfT) can be a powerful way to address trade and growth constraints in poor countries. The European Union (EU) provides more than a third of total AfT, and so it must play a leading role in the future. In doing so, it needs to put in place a more focused strategy in ensuring AfT will actually help production and trade flows in the poorest countries. Such a strategy consists of some of the following:

1. Efforts must not be limited to passively mainstreaming trade policies in the national development agenda, but must ensure trade policies remain alive and central to the design of development strategies.
2. Notwithstanding context specificities, priority should be given to developing trade infrastructure and connectivity, increasing production capability and capacity, building trade skills and knowledge and improving technical expertise to meet global trade standards.
3. Greater use of budget support and sector-wide approaches (SWAp) to delivering and implementing AfT investments is necessary.
4. Also key is improved coordination in the identification of AfT needs as well as joint monitoring and evaluation of AfT investments.

EU AfT flows

The EU together with its Member States remain one of the largest providers of AfT, providing about \$12.6 billion in AfT¹ to developing countries in 2010: about 40% of total AfT flows in that year. While the rate of increase was 9% from 2006 to 2009, it has since slowed to about 4%, thereby raising the importance of maintaining momentum behind the AfT agenda.

Allocation of AfT by the EU and Member States in 2010

Sector	AfT flows (US\$ millions)	% of total	% change (2006-2010)
1 Energy	2,748	22	24
2 Agriculture	2,320	19	21
3 Transport and storage	2,182	18	7
4 Banking and financial services	1,524	12	15
5 Business and other services	820	7	10
6 Industry	766	6	8
7 Trade policies and regulations	707	6	28
8 Forestry	691	6	34
9 Communications	261	2	8
10 Fishing	127	1	6
11 Mineral resources and mining	86	0.69	17
12 Tourism	75	0.61	20
13 Total EU AfT	12,605	39	-
14 Worldwide AfT	32,417	-	-
15 Total EU aid	71,020	-	-

Note: These figures are based on calculations using the Organisation for Economic Co-operation and Development (OECD) Creditor Reporting System (CRS) database. They are for AfT disbursements and use current US\$. Exchange rate: €1 = \$1.32.

Source: <http://www.openeurope.org.uk/Content/Documents/PDFs/eaaid2011.pdf>.

The magnitude of AfT flows surpassed the EU's 2005 target of €2 billion by 2010, with the energy sector in developing countries the largest recipient (\$2,748 million in 2010), with an annual average growth rate of 24%. Agriculture (19% of the total) and transport and storage (18% of the total) were the second and third largest recipients. Trade policies and regulations stood seventh, with 6% of total 2010 flows, although this sector saw one of the highest (28%) average annual rates of increase in AfT flows between 2006 and 2010.

There is growing empirical evidence that AfT investments have a positive impact on developing countries' trade performance (Cali and te Velde, 2008), which in turn is a critical driver of economic growth. AfT investments have

been addressing key bottlenecks – both institutional and physical – that inhibit trade growth. By unlocking the trade potential in developing countries, particularly in LDCs, it has been able to translate trade into a locomotive for economic development at large. Moreover, trade, by promoting better allocation of resources, transfer of knowledge and technology and structuring investment incentives, can play an important role in addressing key developmental challenges such as food security, climate change, natural resource scarcity and so on. In doing so, AFT presents the best value for money.

Notwithstanding the impressive growth in flows, the EC Communication rightly points to some of the most pressing challenges in equally ensuring their quality and impact. In particular, it draws attention to better targeting and coordination which, in addition to monitoring and evaluating flows and impacts, are part of ODI's ongoing research on AFT.

Issues and challenges

Coordination of AFT needs and strategies remains an area of concern, both within developing countries and between donors and recipients (Luke and Bernal, 2011). In order for AFT to be effective, it must be aligned with trade and development strategies on the national development agenda, whereas in many cases, particularly in Least Developed Countries (LDCs), trade issues are either absent or muted. When trade is mentioned, it is often limited to 'improving trade performance' and does not accompany associated policies and strategies to achieve such goals. Furthermore, rather than proactively leveraging trade as an integral component of achieving border developmental outcomes, it is given merely a passive mention. The point being raised with regard to making AFT effective is that there exists a sequencing issue in AFT coordination. First, trade and trade issues must be mainstreamed into the national development agenda, whereby the linkages between trade and the rest of the economy are well articulated, the weakest links identified and strategies devised to address them. This relates to internal coordination with different line ministries, private sector, civil society and research bodies in the developing country. Second, AFT will be effective in the presence of such articulation, as it facilitates better and more strategic targeting of AFT. Here, the issue will be coordination between the donor and the recipient country.

Experience thus far shows that the articulation of trade and trade issues on the national development agenda remains limited. LDCs benefit from Diagnostic Trade Integration Studies (DTISs) under the Integrated Framework process. These provide valuable articulation between trade and the rest of the economy; however, many fail to be mainstreamed into the national development agenda, thereby existing parallel with other similar development policy documents.

Nonetheless, the EC and EU Member States have been playing a leading role in facilitating donor–recipient coordination on AFT at the country level. In many LDCs, the EC or EU Member States play an important as 'donor coordinator' in the Integrated Framework process. As the LDC selects this donor coordinator, many have favourably identified the EC or the EU Member States for this role. Trade officials in developing countries have stated that their preference is based on their perception of EC and EU Member States having more knowledge of and better working relationships on AFT and trade issues, and being more likely to foster consensus and coalition between various domestic and external actors. The EC's work on budget support has also helped to build such perceptions in developing countries.

The Communication's mention of budget support in the context of AFT is welcome, but it will need to be developed further in order to operationalise such an approach, which exists for other aid flows for the most part. In our research, the majority of developing country respondents to the OECD/World Trade Organisation (WTO) question on AFT in 2011 stated that they would like to see more usage of budget support and SWAp in AFT flows and interventions. However, a recent report by Stephen Booth and Siân Herbert (2010) caution on the usage of such tools given that they remain untested. Cambodia has employed a SWAp in its AFT programming (particularly in the Integrated Framework), which has shown positive results. Such experiences could be studied to identify best practices that can be scaled up and replicated for AFT programming in other developing countries.

In noting the above, the Communication stops short of discussing some vital trade and development issues. It acknowledges the importance of Non-trade Barriers (NTBs), yet linking these and trade facilitation issues to AFT would have further enriched it. For example, many LDCs, whose exports are predominantly non-manufactured goods, for which such barriers are acute, face insurmountable challenges and lack the resources and capacity needed to meet complex technical requirements and standards. Discussion on trade facilitation issues such as these and AFT would have sharpened the focus of the Communication. Furthermore, while the Communication discusses the changing landscape of the world economy, it fails to discuss adequately emergent trade issues such as the implications of climate change, natural resource scarcity, food security, industrial policy, labour mobility and so on. Trade can play a critical role in addressing and alleviating these challenges. Moreover, linking these emergent trade issues to the discussion on AFT would have presented practitioners with a more powerful lens going forward.

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Footnotes

1. The WTO AFT Working Group defines the scope of AFT broadly as 1) trade policy and regulations; 2) trade development; 3) trade-related infrastructure; 4) building productive capacity; 5) trade-related adjustment; and 6) other trade-related needs. However, actual AFT flows are recorded in terms of support to trade policy and economic sectors, as shown in the table.

Protecting Developing Country Growth from Global Shocks

Stephany Griffith-Jones and Dirk Willem te Velde

The global financial crisis as well as food and fuel price increases have had a great effect on developing countries. Even though there is a common perception that poor countries were relatively unaffected by the 2008-2010 financial crisis, we estimate that sub-Saharan Africa lost around 5% of Gross Domestic Product (GDP) (compared with forecasts prior to the onset of the crisis). Contrary to perceptions, sub-Saharan Africa is a net oil importer (although there are of course some major exporters), and small and vulnerable countries (as a group) are net food importers, so high and vulnerable food and oil prices have very negative effects.

Sudden external shocks can involve sudden net capital outflows, sudden declines in export revenues, increased costs of essential imports such as food and oil products or declines in remittances. These will affect growth and government revenue. This can lead to increased poverty in the short term, as well as a reduction in critical expenditures, which can have long-lasting negative development effects. Donors and international financial institutions have designed shock facilities to cushion the impact of shocks on the poor and protect critical spending categories, so as to sustain growth. Given that global shocks are expected to increase in frequency and magnitude (see, e.g., the World Economic Forum Global Risk Reports), it is important that the growth prospects of the poorest countries are safeguarded.

The European Commission (EC) has put in place various shock-absorbing schemes, most recently the FLEX, Vulnerability FLEX (V-FLEX) and Food Facility initiatives. Past schemes have a number of strengths and weaknesses. The EC Communication suggests the European Union (EU) 'can help partner countries make use of market-based insurance mechanisms, like the commodity futures market, to hedge against revenue

shortfalls. Building on the V-FLEX set up in 2009 to help mitigate the effects of global food and financial crises on African, Caribbean and Pacific (ACP) countries', the EU 'will work to set up a new shock-absorbing scheme focusing on broader exogenous shocks with a cross-country dimension'. We argue the EU should be ambitious, building on the effective V-FLEX scheme, and reform its shock facilities to include resilience and resilience building.

Economic shocks have become more important ...

Shocks have become more important in today's globalising world. Te Velde et al. (2011) review the evidence showing shocks can have a large effect on growth, poverty reduction and government expenditure and development. The global community has responded. The Group of 20 (G20) development agenda was explicitly about growth and resilience and the International Monetary Fund (IMF) has been enhanced during the crisis to focus on balance of payments support. A European angle is key to protect critical spending such as on social and infrastructure projects.

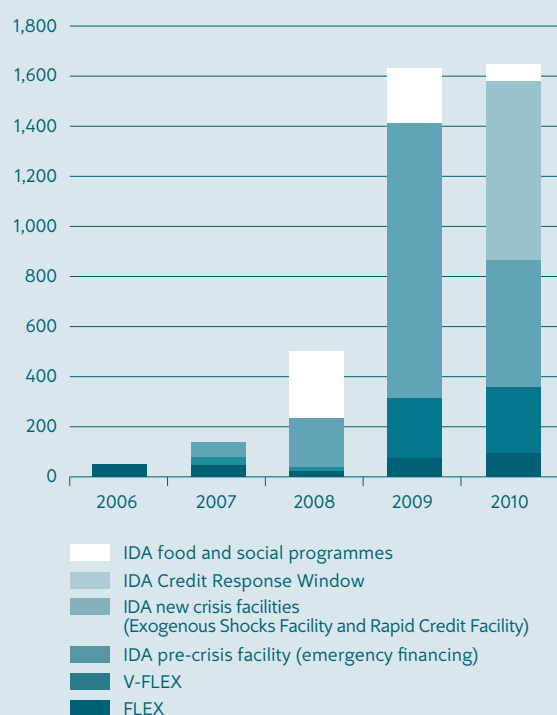
... Therefore it is important to devote attention to dealing and coping with shocks

There are various ways of dealing with economic shocks, including: (1) resilience building to improve dealing with shocks; and (2) providing finance in case shocks affect critical spending. Large donors such as the EC could lead the way in two ways: (1) they are large donors on their own, with development and shock components in their indicative programmes; and (2) they can coordinate and pool loan and grant resources for a large European shock facility, which could incorporate resources from other donors.

Scale and speed are particularly important criteria for shock absorber schemes, including those of the EU, so they can have a genuinely counter-cyclical and significant effect on developing countries facing external shocks. It would seem desirable to increase the proportion of donor resources going to shock absorber schemes, as shocks seem to be a major cause of lower growth in developing countries and have become more frequent, because of both more frequent financial crises and the impacts of climate change. Furthermore, even for liquidity facilities (e.g. those of the IMF), greater emphasis on significant low conditionality lending in the face of shocks seems highly desirable.

Of course, developing countries themselves need to improve their resilience to shocks by building up financial buffers and diversifying their economic activities. However, donors can coordinate efforts and support these activities, especially in countries that are inherently more exposed to crises. One lesson from the recent global financial crisis is that donors and the IMF were able to support developing countries at a meaningful scale and speed (see Figure). In this sense, the V-FLEX was successful in delivering finance to those in need and in a coordinated way.

Shock financing by crisis facility, 2006-2010 (€ millions)



Source: te Velde et al. (2011).

The next multiannual financial framework will cover the period 2014-2020. If some €22 billion is found, we assume at least €1.1 billion or 5% (adding FLEX and V-FLEX amounts in the previous period) will need to be reserved for a shock facility, and more could be pooled

from EU bilateral states. The World Bank's International Development Association (IDA) crisis facility reserves a similar proportion from all IDA resources to deal with crises. However, we feel €3 billion is a better approximation of what would be needed to deal with another big shock such as the global financial crisis, now extended as a European sovereign debt crisis.

So what might be the key elements in a new European approach?

Access to the new shock facility needs to be simple and flexible, yet also predictable. There should be a set of clear *trigger variables*, for example using forecasts such as those on GDP and the current account as elements, because this allows for faster allocation of resources (in the past, EU shock facilities were notorious for disbursing funds four years after the shock, with V-FLEX a positive exception). A case can be made for spending some resources on monitoring shocks, for example supporting a team of researchers at the EC or IMF and doing this in collaboration with partner countries. Such a team could monitor categories of variables more closely related to preserving critical spending but which might not be readily available on international databases, including data on government spending. If a new shock absorber scheme needs to address shocks quickly and at sufficient scale to protect critical spending, it needs to have up-to-date information on the underlying financing situation, and this can facilitate *ex-ante* engagement with countries to ensure an optimal impact from the shock facility. A further decision is required on the threshold used for each trigger variable. The tighter the *threshold*, the fewer countries are eligible.

Our study in May 2011 (te Velde et al., 2011) examined the pros and cons of different trigger variables and suggested using country-specific GDP shocks (or fiscal shocks if data were available) on the basis of IMF forecasts, verified by in-country examination with partner countries, initially using a 3% threshold (or changed to the median GDP shock). The trigger value of 3% reaches around half of the countries in the first instance (at least based on the 2009 shock). In other years, such a trigger may not be sufficient, so one could consider changing the trigger threshold to the median shock, closer to 1% (too high a threshold might make the shock system too inflexible). The trigger threshold would be country specific (and not group specific or necessarily as high as in the IDA Crisis Response Window (CRW), whose thresholds are considered too tight).

Current shock facilities such as FLEX and V-FLEX are for *ACP countries*, but a new scheme could be for all developing countries (the Food Facility was one such example), all Least Developed Countries (LDCs) or all Low-Income Countries (LICs). Given that the EDF is unlikely to be budgetised for the period 2014-2020, and

following the Cotonou Partnership Agreement, it might be useful to remain focused on the ACP for now, but to begin to extend shock facilities into all developing countries (and finding new resources) by the next period from 2020 onwards. This means preparations could start now by extending the new FLEX scheme to all developing countries while bringing in additional resources from the EU budget.

Our report suggested an innovation which could be introduced into future EU shock facilities: the incorporation of the concept of resilience and resilience building. We argue that resilient countries are better able to withstand shocks, hence less resilient countries should receive more funding *ex-post*, while (to counteract the moral hazard problem) *ex-ante* more funding should be devoted towards resilience building. If we accept the argument that resilience is a good criterion for funding, we might conclude that small, poor and vulnerable economies are most likely to receive funding in the case of shocks. Thus, EU shock absorber payments should take into account whether countries are resilient to shocks.

We also examined channels of delivery. The EC specialises in grant resources, and we suggest this would continue to be relevant for LICs. V-FLEX paid resources through budget support, which could be continued for those countries ready to receive this and in coordination with other development institutions. We also argued that the EC could use its coordinating role and bring in other funders, for example loans from the European Investment Bank (EIB) and/or bilateral lenders such as the German Development Bank (Kreditanstalt für Wiederaufbau, KfW). In addition, critical spending, which needs to be maintained in the face of shocks, is often related to large infrastructure projects that require project financing; this could be provided by the EIB, including by using blending schemes, financed from EC resources. The EC could also liaise with other institutions such as the World Bank and Regional Development Banks (RDBs) in the delivery of project finance. Working with others could also help to improve additionality and the leveraging effect of the EU's interventions, as well as providing sufficient scale to deal with large shocks.

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Instruments to Boost EU Foreign Direct Investment to Developing Countries: Clearer Strategy and More Focus Needed

Dirk Willem te Velde

The European Commission (EC) Communication calls for complementary instruments to boost FDI to developing countries. It argues that FDI has bypassed the ‘countries most in need’ and that the EU can help to improve the business environment through: (1) investment provisions in RTAs; (2) investor protection in bilateral investment agreements; and (3) schemes that blend loans and grants to ‘support the financial viability of strategic investments’.

A number of issues need attention: (1) the three measures on their own are not enough to promote FDI – the question is how they fit in the overall picture; (2) this does not take into account developing country views on these measures; and (3) there is much more the EU can do to make engagement with the private sector more effective (what we call EU home country measures, see te Velde and Bilal, 2005). It is notable that the Council Conclusions on the Communication fail to mention FDI instruments at all.

Let us first consider the strategy behind promoting FDI. It is well known that there are a range of factors helping to promote FDI. These can be loosely divided into host country factors, home country factors and international factors (te Velde, 2007):

- **Host country factors** include market size and growth, economic fundamentals (skills, infrastructure), technology (strategic assets), natural resources (e.g. mineral resources), industrial (e.g. incentives, special economic zones, Special Economic Zones (SEZs)), trade and macroeconomic policy and governance generally.
- **Home country factors** include support to economic fundamentals and governance structures in host countries (e.g. aid), support to reducing economic and political risks of investment projects, support to providing information surrounding in-

vestment projects (investor missions) and other policies that affect the viability of overseas investment projects, such as unilateral trade, tax, corporate social responsibility and corruption policies.

- **International agreements** include bilateral, regional and multilateral provisions on investment provisions.

The Communication focuses on only a small subset of measures without acknowledging the crucial importance of developing countries’ growth and their fundamentals, policies and institutions in attracting FDI. If the objective is to promote more investment in developing countries, it is more efficient to pull rather than push it in. If the profitable project is not there, no amount of investor protection will lead to more FDI.

We should further mention that it is the quality of FDI that matters, not just the quantity. In fact, LICs as a group receive more FDI than others (when scaled for market size) (see Table). And what is the EU doing to make FDI work for development? Could it use home country measures to promote the development impact? Overall, the impact of FDI on development will depend on the type and strategy of investors, as well as host country conditions, policies and institutions. So, in short, it is important that FDI measures are part of a strategic framework behind both attracting FDI and making FDI work for development.

Second, the EU aims to use investment provisions in bilateral and regional investment treaties. Many bilateral investment treaties already exist, whereas small, vulnerable and poor countries have largely resisted signing investments in regional agreements (with the exception of the Caribbean). As such, it is not clear how much such provisions will be implemented; even where they are implemented, it is not clear how much they will help (the presence of investor protection might be seventh down the list of key factors behind FDI).

Finally, existing measures, including those mentioned in the Communication, are not sufficiently geared towards facilitating private investment. What actually is the interface between the EU and private investors? How does the EU work with investors? The blending mechanisms mentioned have until recently been used mostly for public sector projects (e.g. the EU–Africa Infrastructure Trust Fund, ITF), and are being accessed mostly by public sector financiers, such as the French Development Agency (Agence Française de Développement, AFD), KfW and the EIB, rather than private sector European development finance institutions (DFIs), such as DEG, Proparco and CDC, which are looking to finance sustainable and financially viable projects. For the EU blending schemes, we estimate that one unit of grants leverages in between five and six units of public sector loans (for both the ITF and the Neighbourhood Investment Facility, NIF) and another fifteen units of other finance. Thus, aid grants are likely to leverage in substantial amounts of other development finance, including for regional infrastructure as part of the ITF.

But in order to promote FDI, blending mechanisms need to be tailored more towards the needs of private sector while still promoting development. Grants and DFI finance can be used to leverage in private investment: DFIs are backed by implicit and explicit subsidies, and these can help to mobilise additional capital, including for infrastructure. Some \$33 billion of DFI investment is invested in the private sector each year; around a third of this goes to infrastructure. Every dollar of CDC investment coincides with \$5 of other investment; every International Finance Corporation (IFC) dollar leverages about \$3 from others; every European Bank for Reconstruction and Development (EBRD) dollar leverages in another \$1. Massa and te Velde (2011) find that private sector DFIs do leverage in investment and growth in the macro sense: a one percentage point increase in DFI investment as a percent of Gross Domestic product (GDP) leads to a 0.8 percentage point change in the investment to GDP ratio. The authors (2011) argue that the international community should scale up project preparation funds, especially for large infrastructure projects, and leverage in private investors and sovereign wealth funds, as also emphasised by the the Group of 20 (G20) high-level panel on infrastructure. The EU could also consider this.

Importance of exports, FDI and remittances by country group, 1970-2010 (% of GDP)

	1970	1980	1990	2000	2008	2010
Exports of goods and services						
LICs	12.7	13.2	11.9	17.5	21.4	19.7
MICs	9.6	15.4	19.1	27.3	32.1	28.5
OECD members	12.7	17.5	17.4	22.2	25.9	24.9
Sub-Saharan Africa	21.8	31.9	26.4	32.4	35.9	29.7
East Asia and Pacific	7.7	16.9	22.3	35.3	42.3	37.2
Latin America and Caribbean	10.0	13.2	17.0	20.0	23.8	22.3
FDI, net inflows						
LICs		0.4	0.3	1.5	3.2	3.4
MICs		0.6	0.7	2.6	3.7	2.6
OECD members		0.5	0.6	1.0	5.4	2.7
Sub-Saharan Africa		1.3	0.1	0.3	2.0	3.7
East Asia and Pacific				1.6	2.6	3.7
Latin America and Caribbean	0.4	0.8	0.7	3.8	3.0	2.3
Workers' remittances and compensation of employees, received						
LICs		1.5	1.7	3.2	8.1	7.2
MICs			1.1	1.3	1.8	1.6
OECD members		0.3	0.3	0.3	0.4	0.3
Sub-Saharan Africa		0.6	0.7	1.6	2.3	2.2
East Asia and Pacific				0.5	0.9	1.5
Latin America and Caribbean		0.3	0.5	1.0	1.5	1.2

Source: World Development Indicators.

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The Different Approaches to Differentiation

Siân Herbert

Over the past decade, the world has witnessed significant changes in economic flows, geopolitical realities and poverty patterns, and this is expected to continue. These changes have created new needs, capacities and responsibilities for developing countries, donors and the research community. They also challenge traditional development ideas, tools and actors. Central to these changes are the needs and roles of MICs, particularly emerging economies, in a new poverty landscape.

Following a period of economic growth, many developing countries have now graduated from being Low-Income Countries (LICs) to Middle-Income Countries (MICs), and this trend looks set to continue over the next decade. At the same time, the deepening economic crisis in Europe has ushered in a period of austerity, with public expenditure under increased scrutiny to show results and value for money. In many developing countries, stronger economic growth means aid is becoming a less important source of development finance, while trade concessions and other forms of cooperation are increasingly important. However, the arbitrary boundaries of the MIC income group masks the varying needs and capacities of the countries. Persistent pockets of poverty, vulnerability to shocks and an increasingly important role in multilateral fora mean MICs are still central to global poverty reduction.

Differentiation

The European Commission (EC) has initiated a series of reforms to its trade and development policies, in an effort to 'differentiate' between the diverging needs and capacities of developing countries. Considering that the European Union (EU) is currently the world's largest importer and the largest provider of Aid for Trade (AfT), and provided 60% of global official development assistance (ODA) in 2010, these policy shifts can have significant impacts for individual developing countries as well as the international development agenda.

The EC has taken a multifaceted approach towards 'differentiation', which involves not just differentiation in trade policy (as discussed by Stevens in Essay 5, but also in aid, climate change and shock facilities (see Griffith Jones and te Velde in Essay 12). A comparative summary of these approaches can be seen in the table below. While differentiation among developing countries seems to reflect economic motives – both at home and abroad – it is also the result of domestic and foreign policy concerns. As emerging economies become stronger players in an increasingly competitive and multipolar world, we expect more emphasis and discussion on EU graduation in the coming decade across the areas of trade, aid and climate change. We need to see the current EC communication in this light.

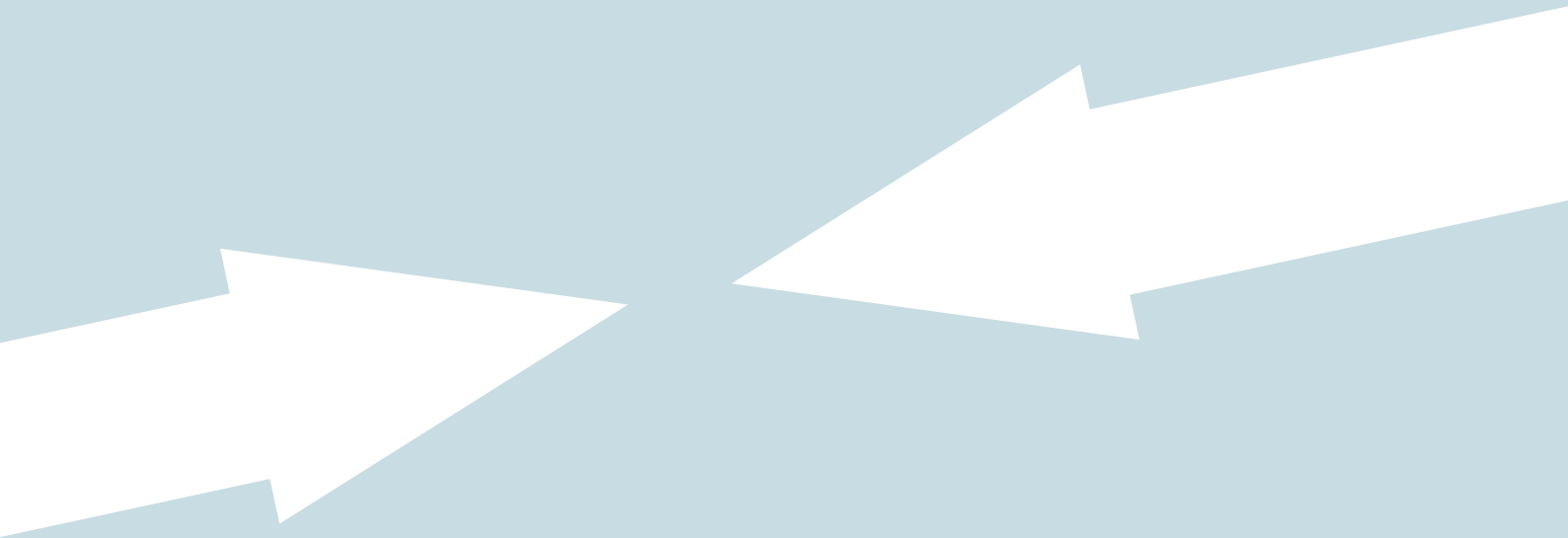
Different approaches to EU differentiation among developing countries: comparing recent developments

	Trade	Aid	Climate	Shock facilities
Examples of relevant schemes	Generalised System of preferences (GSP), GSP+, Everything but Arms (EBA)	Differentiation, differentiated development partnerships	Common but differentiated responsibilities (CBDR)	FLEX mechanism, V-FLEX, Food Facility
Concept	GSP preferences should focus on countries most in need.	Evaluation of developing country 'capacity' and 'potential EU impact' in aid allocation process.	Emerging economies can afford to increase commitments; their role is crucial to lower emissions.	Shock-absorbing schemes cushion impacts on the poor and protect critical spending categories to sustain growth.
Recent developments	In 2011, the EC launched a proposal to reform the GSP; this includes the most radical change in the eligibility of states since the GSP was created three decades ago, as a result of which the number of beneficiaries would be cut from 176 states to about 80.	In 2011, the EC proposed a new development strategy – An Agenda for Change – which updates the vision established in the European Consensus on Development (2005) and introduces 'differentiation' and 'differentiated development partnerships'.	At COP 17 in Durban (2011), key emerging economies agreed to pursue a legal framework on carbon emissions, establishing the Durban Platform. Central to the deal was the EU, LDC and Alliance of Small Island States (AOSIS) alliance that emerged.	FLEX (established 2000, revised 2004 and 2008) aimed at safeguarding socioeconomic policies affected following a fall in export earnings. The temporary V-FLEX (established 2009) addressed impacts of the global financial crisis and was based on forecast development finance gaps. The Food Facility (established 2008) responded to rising/volatile food prices.
Basis for differentiation	<p>GSP membership will be reduced, leading to higher imports tariffs on:</p> <ul style="list-style-type: none"> All imports from Upper-Middle-Income Countries (UMICs) that do not have a Free Trade Agreement (FTA) with the EU – 'income graduation'; Some imports from those Low-Middle-Income Countries (LMICs) and LICs not covered by the GSP+ regime – 'product graduation'. 	<p>New aid allocation criteria to reduce/stop bilateral aid according to:</p> <ul style="list-style-type: none"> OECD Development Assistance Committee (DAC) income categories (UMICs excluded); Gross Domestic Product (GDP) (countries with more than 1% of global GDP excluded); Additional criteria considered: Human Development Index (HDI), Economic Vulnerability Index, aid dependency, economic growth and FDI. <p>Differentiated development partnerships including loans, technical cooperation, support for trilateral cooperation.</p>	<p>The present legal criteria for CBDR (Article 10 of the Kyoto Protocol) divides countries into three main groups with differing climate change commitments:</p> <ul style="list-style-type: none"> Annex I (industrialised countries that were members of the OECD in 1992, plus countries with economies in transition (EITs)); Annex II (OECD members of Annex I, but not EITs); Non-Annex I (mostly developing countries). <p>Following Durban, carbon emission targets will be extended to all parties, with substantial commitments for Brazil, Russia, India, China and South Africa (BRICS). However, the criteria have not been agreed yet.</p>	<p>FLEX pays according to past export earnings; V-FLEX looks at predicted finance gaps and incorporates some elements of vulnerability.</p> <ul style="list-style-type: none"> FLEX: Eligibility depends on a 10% (2% in the case of least developed, landlocked, island, post-conflict and post-natural disaster states) loss of export earnings from goods. The drop must be 0.5% or more of GDP. V-FLEX: Allocation depends on a loss of government revenues or declines in forecast fiscal financing gaps adjustments for vulnerability and sufficient absorptive capacity. Food Facility: Allocation depends on poverty, need; potential social and economic impact related to reliance on food imports, social vulnerability, political stability and macroeconomic effects on food price developments.
Countries affected by recent changes to differentiation	<p>The number of countries eligible for GSP trade concessions will fall from 175 to about 80.</p> <ul style="list-style-type: none"> Eight countries will face product graduation: China, India, Indonesia, Iraq, Nigeria, Thailand, Ukraine and Viet Nam; 17 UMICs that do not have FTAs negotiated will be excluded. 	<p>Countries funded through the Development Cooperation Instrument (DCI):</p> <ul style="list-style-type: none"> 17 UMICs: Argentina, Brazil, Chile, China, Colombia, Costa Rica, Ecuador, Kazakhstan, Iran, Malaysia, Maldives, Mexico, Panama, Peru, Thailand, Venezuela and Uruguay; Two LMICs with more than 1% of global GDP: India and Indonesia; Exceptions: South Africa and Cuba. 	<p>The BRICS are expected to engage in emission reduction.</p>	<ul style="list-style-type: none"> LICs and MICs are eligible through the African, Caribbean and Pacific states (ACP); a question emerges over MICs and Small and Vulnerable Economy states (SVEs).
Main issues	<ul style="list-style-type: none"> UMICs are not a proxy for 'the most competitive developing countries' (e.g. China will remain in but Cuba will be excluded). Likely beneficiaries will be HICs, which export the affected goods. Is it just protectionism? 	<ul style="list-style-type: none"> The EC should publish detailed criteria/formula and country-by-country impact assessments. Limited funding allocated to the differentiated partnerships. Could it be applied to the EDF? 	<p>The BRICS hold the key to change, but it is challenging to broker a binding deal that they will sign up to.</p>	<ul style="list-style-type: none"> These schemes are for ACP countries, but there are questions as to which countries should receive what payments. How to redesign these facilities to focus more on the most vulnerable countries, in particular LICs? Needs to incorporate resilience.

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Regional Views



Strengthening Economic Partnership Agreements and the Future of the EU–Africa Trade Relationships in the Next Decade

Ali M. Mansoor, Vishnu Bassant and Salomon Samen

This section suggests a way out of the present EPA deadlock and proposes a practical approach that would: (1) better prepare Africa for the future of EU-Africa open trade relationships under EU-Africa full EPAs; and (2) maximise the chances of success in terms of greater integration of African economies into European and global markets.

With Free Trade Agreements (FTAs) proliferating and now becoming the principal means for liberalising trade, the approach suggested here stands against the background of the current World Trade Organisation (WTO) Doha global trade impasse and the lack of enthusiasm of African policymakers for moving aggressively towards FTAs as proposed under EU full EPAs.

We first explore the key flaws in the design of EPAs. After this, we propose a two-step approach framework to allow for a gradual, smooth but rapid integration of African economies into global markets, while creating regionally competitive markets in Africa in preparation for the future of EU-Africa open trade relationships under full EPAs between the EU and Africa.

Key flaws in the design of EPAs

Although very well intended, EPAs contain severe flaws: (1) a bias against African regional integration (EPA countries to be open to the EU but not to their African neighbours, because of limited progress on African regional integration; hub and spoke effects; fragmentation of existing markets, with Africa trading with the EU under multiple arrangements: countries benefiting from Everything but Arms (EBA) versus others; (2) significant trade diversion; (3) restricted and complex rules of origin; and (4) no significant support to the alleviation of supply-side constraints and improved competitiveness.

While the alleviation of supply-side constraints is necessary to respond to the expected opening of EU markets as a result of full EPAs, current support and offers of development assistance are vague and lack specifics. This uncertainty should be tackled with dedicated and predictable resources in the spirit of the cohesion fund used for the transition of Eastern Europe from centrally planned to market economies and for the EU enlargement during the accession of Iberian countries (Portugal and Spain), rather than along the lines of existing Aid for Trade (AfT) programmes, which are perceived to be small in value and which lack focus. Rules for such financing need to be aligned to promote policy reforms aimed at a single market behind low barriers. Necessary policy reforms include measures to: (1) reform the tax system to be less dependent on trade taxes and rely more strongly on value-added tax (VAT) and other taxes on consumption; (2) improve doing business and competitiveness indicators, given serious weaknesses in the business and investment climates in Africa, as well as promoting small and medium enterprises (SMEs) by ensuring upstream and downstream linkages of local firms with global supply chains; (3) develop public infrastructure; and (4) expand the use of Special Economic Zones (SEZs).

Dedicated and predictable financial support is essential to: (1) meet adjustment costs for firms and workers, for the technical and financial assistance needed to mitigate temporary revenue losses and mitigate the negative impact of integration adjustment (the way the structural and cohesion funds were used for Iberian as well as Central and Eastern European countries' accession to the EU); (2) support implementation of business reforms; (3) improve infrastructure to take advantage of increased export opportunities; and (4) scale up capacity-building needs (the way international organisations – the Bank for International Settlements (BIS), the European Bank for reconstruction and Development (EBRD), the International

Monetary Fund (IMF), the Organisation for Economic Co-operation and Development (OECD), the World Bank and the WTO – supported the Joint Vienna Institute (JVI) to provide instruction of the highest standards to help the transition of Central and Eastern Europe economies from centrally planned to market-based economies).

A two-step approach to free trade with the EU and accelerated economic transition in Africa

In line with the infant industry argument advocated in the 18th and 19th centuries by Alexander Hamilton and Friedrich List, and resuscitated more recently by authors such as Ha-Joon Chang, we argue that, as nascent African industries do not have the economies of scale of their older competitors from Europe, and as they operate in a business environment littered with supply-side rigidities and limited skilled labour, they need some time for preparation/adjustment until they can attain similar economies of scale and production efficiency.

A two-step approach is proposed here to allow for a more gradual transition towards open competition with the EU in the long term.

- The first stage of the proposed approach could last five years, and would focus essentially on the advancement of deepened regional integration aimed at a full FTA in the entire Africa region, which would occur when sub-regional level integration moves in tandem. Emphasis would be put on broad regional integration measures rather than simply focusing narrowly on trade in goods, with trade in services, movement of capital/ regional financial market integration at the centre of discussions. The first stage should not support a trade-diverting common external tariff (CET), but commit funding to trade-creating tariff liberalisation based on lowest non-zero tariff. When tariffs are relatively high in a country (around 30%), firm commitments should be made to lowering them within five years to not more than 15% to avoid a trade-diverting CET. The proposal to focus in the first five years on intra-regional trade liberalisation in Africa would make the EPA more politically acceptable in the first phase and pave the way for full reciprocity in the second phase.

- The second stage would move towards a full EPA/ FTA as expected by the EU through a plurilateral FTA between the EU and Africa aiming to cover all major trade issues, including services, step by step. This could be realised well in advance of the 15 years provided in the current interim EPAs.

With substantial political commitment in Africa, as expressed by African Heads of States in the Lagos Action Plan (1980) and the Abuja Treaty (1991), and more recently during the January 2012 AU Heads of States Summit, policy reforms and actions formulated in this proposal to advance regional integration and progress towards a FTA with Europe would be feasible if strongly backed by: (1) dedicated, timely and quick disbursing development assistance structured in the spirit of the EU cohesion funds serving as incentives to countries to implement reforms; and (2) massive capacity building.

Beyond Fish and Coconuts:

Will the New EU Trade Policy Support Development in the Pacific Islands?

Nikunj Soni and Derek Brien

Simply put, the answer to the question above is probably no.

In January this year, the European Commission (EC) released its Communication on Trade, Growth and Development with the stated intention of ‘tailoring trade and investment policy for those countries most in need’. There is much to be commended in the Communication, most notably the recognition that one-size-fits-all policy is less relevant (assuming of course such an approach was ever actually relevant) in today’s rapidly changing economic landscape. From a Pacific perspective, however, there is concern with the focus on coupling aid and trade.

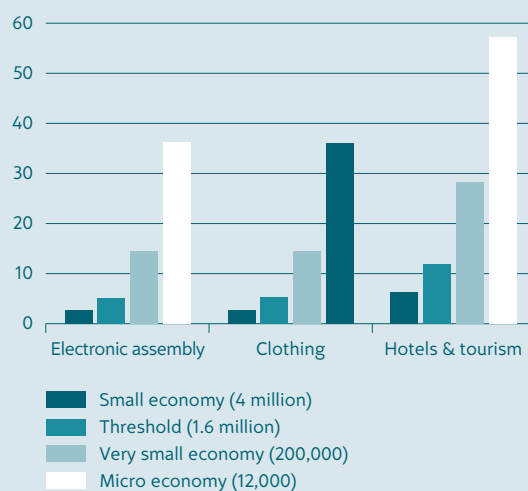
In our discussion paper (Pacific Institute of Public Policy, 2010), we suggest it was timely to rethink the language and assumptions of the prevailing aid-centric approach to development in the Pacific. We also know that the Pacific islands region is so small and isolated that it is almost impossible to trade internationally in goods and only marginally possible to trade in services. In this context, it seems cruel and unjust to link aid to trade instead of broad development needs or economic vulnerability.

There are exceptions of course – notably the two largest Pacific island countries, Papua New Guinea (PNG, population 6.5 million) and Fiji (population 860,000). PNG and Fiji were the only Pacific countries to sign up to an Economic Partnership Agreement (EPA) with the EU – in order to keep preferential access for sugar and tuna exports. These agreements now set a precedent for other Pacific countries should they wish to enter into EPAs in the future. Imports from Europe are small and diminishing, so this should not matter, except that under the most-favoured nation (MFN) clauses any trading rules and tariff rates would also apply to the region’s nearest neighbours, Australia and New Zealand, which could lead to significant negative fiscal consequences.

The big difference is we are small and remote

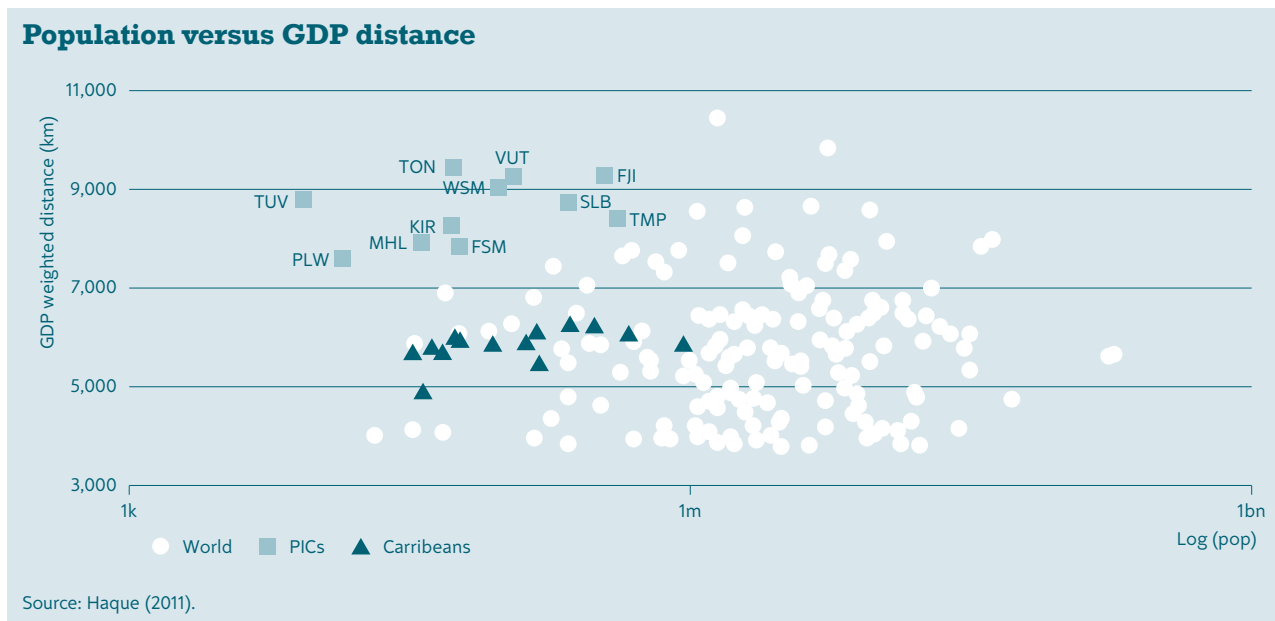
As the following two figures show, the Pacific region is the most economically remote and as a result has the greatest comparative disadvantage when it comes to the production of goods. The small population size of most our nations (generally under 250,000) means the same also applies to services.

Additional costs of production (% of costs in median economy)



Source: Winters, in Haque (2011).

The Pacific often gets compared with the island states of the Caribbean, which also have small populations – but unlike the Caribbean, Pacific island states are the most geographically remote from any major economic hub.



*The message is clear, but has been so often overlooked: unlike anywhere else in the world, the Pacific is **both** small and remote.*

Most Pacific island countries will not trade their way to self-reliance

In his thought-provoking paper, Francis Hezel suggests foreign aid may be not just a stopgap to achieve economic self-sufficiency but a permanent requirement for the Pacific island countries that will always come up short of this goal (Hezel, 2012).

Most Pacific economies are based on subsistence farming, with aid budgets accounting and therefore paying for a large component of each country's trade deficits – partly because of the demands of the aid industry and the lack of locally available products. So, given that most of the Pacific cannot trade their way out of poverty or hardship, linking aid to trade will hinder the prospects for good developmental outcomes from aid. Linking aid with trade in our region will make aid less effective.

The World Trade Organisation (WTO) has divided Aid for Trade (AfT) into six categories, namely trade policy and regulations; trade development; trade-related infrastructure; building productive capacity; trade-related adjustment; and other trade-related needs.

The EC Communication notes that tariff liberalisation alone is not enough to ensure benefits from international trade. This is something that has long been understood in the context of the Pacific region, where a host of supply-side bottlenecks are known to hinder economic performance. Indeed, recent discussions have argued that AfT should not be a substitute for, or compete with, other development aid, nor should it be seen as a substitute for trade liberalisation.

AfT is required to deepen structural economic reforms, enhance the productivity of the business sector and institute regulatory and institutional reforms to create an environment that is conducive to investment and the growth of exports.

Addressing supply-side constraints in the Pacific will need investment in key trade-supporting infrastructure sectors, such as education, health and the development of human resources. Further, as we point out in our discussion paper on regional migration (Opeskin, and MacDermott, 2010), the Polynesian and Micronesian countries of our region have generally benefited from migration for education and employment purposes – a development avenue still not widely available to the Melanesian countries.

Again the message is clear, but often missed: if aid programmes are well designed and implemented, we can, over time, improve trade. However, the converse is not necessarily true: simply removing barriers to trade will not improve developmental outcomes in the Pacific.

Taxing issues

Most of the countries in the Pacific still rely on international taxes to fund a significant portion of their recurrent budgets. Traditional tax theory suggests such taxes may be regressive or inefficient, but this holds true only if you are in economies with some depth in terms of numbers of producers and suppliers. In small island states, it is both costly and difficult to collect domestic taxes, given lack of capacity, remoteness and limited economic activity that tends to be concentrated in a few urban hubs – and as a result these hubs tend to be overtaxed and expensive. Pacific economies generally have little economic depth or value adding, so removing international taxes, which are the simplest and easiest form of tax, makes little fiscal sense: it simply results in a drastic reduction in revenue as the extra profits made by companies is too hard to collect.

Conclusion: our region is unique and merits separate treatment

The EC's shift in language and thinking in its recent Communication is generally to be welcomed, and we can see where the AfT focus can and should apply in the context of African and Caribbean countries. Even in the Pacific, trade has an important role to play in terms of reducing vulnerability, but it is not a panacea. Nor should it be the primary aid delivery mechanism. Aid should be directed at making nations, especially newly independent nations like we have in the Pacific, less and not more vulnerable. Simply reducing tariffs makes countries in our region more vulnerable and not less. The instability and fickleness of most aid programmes has a similar effect, and so linking aid and trade could make the plight of some of the most remote and vulnerable nations on earth – those in the Pacific – worse.

For the Pacific, a better solution would be to link aid to vulnerability. Pacific countries should also be given an opt-out of the EPA, such that they can retain preferential arrangements based on vulnerability alone. If aid can reduce vulnerability over time, and this can be demonstrated, it should trigger talks at a future stage – although the reality is that climate change and other factors may well mean the Pacific should be given indefinite preferential access by extending Everything but Arms (EBA) on the grounds of vulnerability.

Our region is unique and should merit separate treatment.

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Comments on the EC Communication on Trade, Growth and Development

Pradeep S. Mehta, Bipul Chatterjee and Federico Lupo Pasini

On 27 January 2012, the EC announced its Communication on Trade, Growth and Development for ‘tailoring trade and investment policy for those countries most in need’. Overall, the Communication is expected to establish a good platform for the effective use of trade policy to boost economic growth. More than other major players, the European Union (EU) Member States are channelling funding towards Aid for Trade (AfT) initiatives and are already actively pursuing a set of new strategies for trade, growth and development. The following are some comments on this new Communication.

Not enough

It appears that the EU is not making enough effort to promote more effective economic growth in developing countries. Indeed, with the exception of the Generalised System of Preferences (GSP) scheme, most of the tools in EU trade policy are still focused on promoting the liberalisation of strategic sectors in developing countries, rather than creating meaningful market access opportunities for developing countries.

It is undeniably true that developing countries will upgrade their economic status only when they improve the competitiveness of their economies by dismantling monopolies and reducing unnecessary protectionist policies. The EU is correctly encouraging developing countries through its various programmes (AfT, GSP, Free Trade Agreements (FTAs)) to promote domestic liberalisation.

Address the real costs of doing trade

It is not clear why the focus of attention of EU trade policy has not shifted yet towards dismantling the real barriers to trade facing developing countries. For instance, in the new Communication, there is no

mention of trade facilitation. Developing countries urgently need to upgrade their customs and other trade logistics in order to reduce the costs of doing trade. The EU is not doing enough to promote this strategic tool.

The same can be said with regard to other trade-related infrastructure development. More than linking trade concessions to the pursuit of human rights, social or environmental policies (which are nonetheless fundamental components of a sound economy), it is important to associate trade liberalisation with the improvement of transport, customs and logistics regulations.

The EU is becoming more and more active in signing comprehensive FTAs. In most of these, the focus is still on tariff dismantling (especially on the partner country side) and the liberalisation of strategic services sectors (mostly finance and telecommunications). Developing countries need regulatory reforms in almost all sectors, and preferential liberalisation is a good way to push towards this end. In doing so, the EU should give priority to transport, logistics and customs modernisation, rather than focusing just on financial and telecommunication services.

The EU should also open some sectors of its procurement market to FTA partner countries, which could be strategic for developing countries to obtain better access to markets for goods as well as services. This would help many developing countries to improve their competitiveness by obtaining better access to global value chains.

The new GSP policy: will it deliver?

Most market access opportunities are still offered by the GSP scheme. One of the features of the new Communication is the reduction of the scope of the GSP scheme, which will be open only to Least Developed Countries (LDCs) and to countries ‘most in need’.

Studies (e.g. EC, 2011) have shown how Middle-Income Countries (MICs) were actually the main competitors of LDCs in their exports to European markets. Indeed, the five largest exporters covered by the GSP scheme (China, India, Thailand, Brazil and Russia) account for more than 67% of all GSP-covered imports to the EU, whereas LDCs account for only 9%.

If the exclusion of emerging economies from the new GSP scheme effectively increases the market share of LDCs, the new policy is certainly to be praised. On the face it, it may sound a good policy to ‘deliver on development’, but this should be evaluated by aligning consumer interests in EU countries and producer (particularly small producer) interests in exporting countries.

Furthermore, the success of this new GSP policy will depend on the scale involved in addressing supply-side constraints in LDCs – this is why there should be an explicit emphasis on trade logistics and other costs of doing trade in the EU’s strategies for trade, growth and development.

Foreign direct investment

Following the Treaty of Lisbon, it is expected that future EU treaties will contain investment chapters that will bind host countries to a certain regulatory standard. The new Communication makes it clear that EU development policy will use investment agreements in order to promote good governance.

In reality, there is little economic evidence of a direct positive link between international investment agreements and Foreign Direct Investment (FDI), and even less so with regard to the promotion of good governance.

On the other hand, international investment agreements are mainly looked at as a tool to protect the interests of capital-exporting countries and, if not properly designed with specific safeguards, can reduce the policy space of host countries with respect to important socioeconomic development objectives and regulatory policies. Encouraging FDI to developing countries is certainly a good policy, but investment agreements may not have any positive influence in this regard. EU countries should encourage FDI by developing the capacity of host countries so they can gradually adopt internationally agreed regulatory standards on trade in services and in government procurement.

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Regional Integration, Intra-African Trade and Development of the Services Sector

Christian Kingombe and Dirk Willem te Velde

Introduction: the European Commission Communication and regional integration

Compared with normal European Union (EU) discussions on trade and development, which are often full of references to regional integration, this Communication has relatively little on it. It simply refers to the Agenda for Change Communication, which promises greater support to enhance the business environment, to promote regional integration and to help to harness the opportunities world markets offer, as a driver for inclusive growth and sustainable development. The Communication also argues that the EU has consistently sought to promote regional integration, to make countries more attractive to FDI and to spur economic growth. It points to agreements with Central America and CARIFORUM to suggest the EU has supported regional integration processes. The EU promises to review its approach in supporting regional integration, but does not provide details, as already mentioned by Bilal in Essay 5 in this volume. The Council Conclusions (the commitment part) are silent on regional Aid for Trade (AfT), although regions are mentioned in relation to trade measures such as Economic Partnership Agreements (EPAs).

The EU should be more specific about support for home-grown regional integration. One of the African Union's (AU) top priorities is the fostering of intra-regional trade. We argue that there are specific gaps in trade development that can be solved through an African approach. This involves a bottom-up process that considers how trade can contribute to development and what measures to promote trade are required (Cali et al., 2008), rather than what has often happened in the past decade, whereby developing countries were asked to think top-down on what they would commit

(offers and requests for services) in multilateral trade fora. In addition, following the latest trade ministerial at the World Trade Organisation (WTO), the EU can now provide special and differential treatment to services from Least Developed Countries (LDCs).

Regional integration and trade in services

The literature on regional integration dates back to at least the 1950s, when its effects on trade were said to be either trade creating – replacing or complementing domestic production – or trade diverting – when partner country production replaces trade from the rest of the world. If a country becomes a member of a region that diverts trade to its members, it would be better to liberalise globally. The mere reduction or elimination of tariffs on intra-regional trade will have fewer effects if the potential for intra-regional trade is small. For instance, intra-regional trade in Africa covers only a small percentage of total trade, in part because economic and trade (in final products) structures are similar (but perhaps also because of underreporting), so any trade (and hence economic) effect of lower tariffs is likely to be small (te Velde, 2006). Instead, researchers argue that deep integration covering trade rules, trade standards and institutional cooperation would be better for regions.

The literature on deep integration (Meyn and te Velde, 2008; te Velde, 2006) argues that regional integration can be good for growth because: (1) the type and conditions of integration matters; (2) there can be dynamic as well as static effects (e.g. regional integration affects extra-regional Foreign Direct Investment (FDI), see te Velde and Bezemer, 2006), including at micro level (regional exporting is associated with higher productivity, see te Velde, 2011); and (3) there is now more momentum behind actual implementation, for example in the East African Community (EAC). There are also a set of

practical examples where intra-African trade facilitation, for example thorough one-stop border posts), leads to lower transportation costs and fewer delays (e.g. Meyn and te Velde, 2008). All in all, it is crucial to promote the right type of regional integration provisions.

Trade in services

Services are increasingly important in development. As countries grow, the share of services in Gross Domestic Product (GDP) also increases. As argued by Kingombe (2012), services are embedded in all parts and sectors of the economy and affect growth development through four (direct and indirect) pathways:

- Directly, by providing many jobs and incomes for the poor (from distribution to tourism);
- Directly, by affecting development through effects on range and quality of services;
- Indirectly, by forming the backbone of the economy; and
- Finally, by offering an opportunity to diversify and enjoy comparative and competitive advantages (from temporary migration to call centres).

The fast-growing sectors are services such as telecommunications, information and communication technology (ICT) and finance, but tourism remains important for several developing countries. Services have contributed relatively more to growth than other sectors. Trade in services takes up an important share in the export sector in countries such as Cape Verde (76%), Mauritius (75%) and the Seychelles (88%), where services exports made up more than two-thirds of GDP in 2009. The development of services faces a pipeline of constraints, ranging from domestic capabilities to domestic regulations to trade restrictions. Some trade restrictions can be better dealt with at regional than multilateral levels.

Supporting a regional approach to services liberalisation

Kingombe (2012) argues that multilateral services fora for Africa and African EPA negotiations have so far hardly covered meaningful services liberalisation. There is a rationale for a continental African regional approach to remove barriers to services trade and to grow and develop on this basis first. Although several regional economic communities, such as the Common Market for Eastern and Southern Africa (COMESA), EAC, the Economic Community of West African States (ECOWAS) and the Southern African Development Community (SADC), are committed to continuing to strive towards a further deepening of their regional integration in services, investment and migration, there are mixed results when it comes to actual implementation of the provisions in the trade protocols.

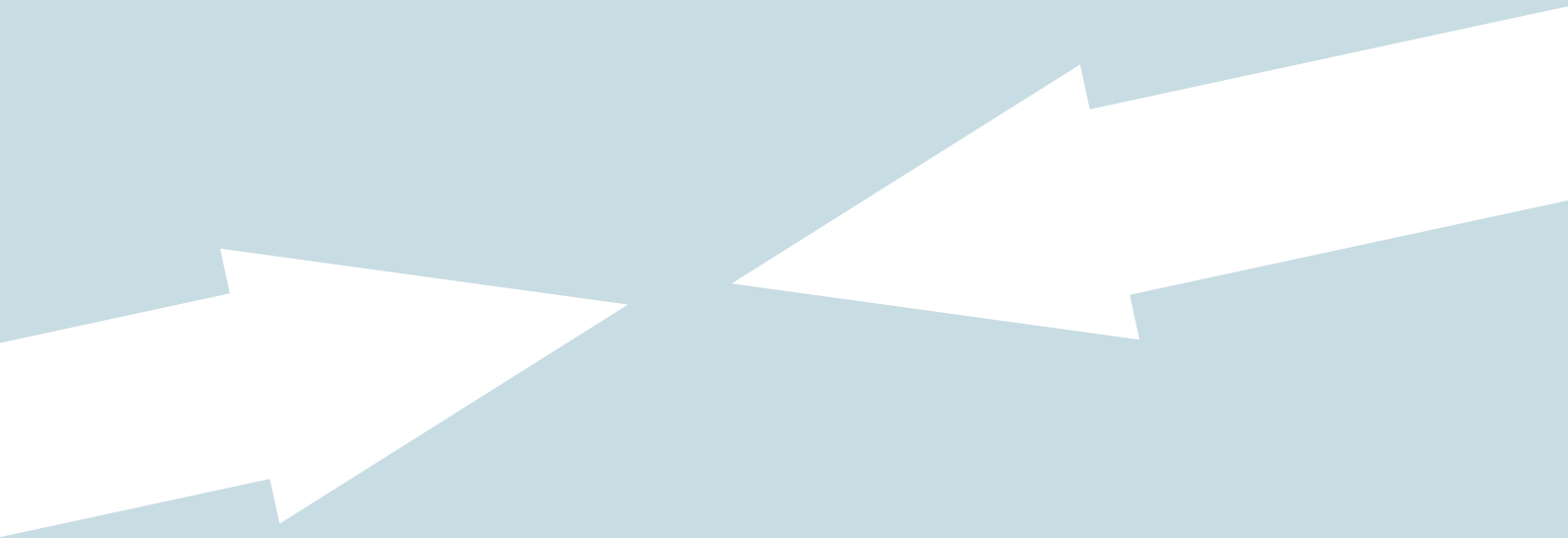
Here is a role for the new, ambitious AU approach on intra-regional trade and services. An overarching African Union Commission (AUC) process might help in setting targets for services liberalisation and reaping synergies among regions. Any AU process, or the tripartite tripartite Free Trade Agreement (FTA), and support agencies will have to build on what has already been achieved in the regional markets of COMESA, EAC and SADC.

The AUC could be provided with a clear mandate and resources to facilitate and monitor this process of regional trade in services liberalisation towards an African internal market (for services). The AUC could play a coordinating role to ensure harmonisation of regulatory policies for appropriate services sectors and of regimes applicable to service providers, as well as organising the overall framework for cooperation among the regulatory authorities at the regional economic community level. The EU could support this process with grants for regional AfT.

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Conclusion



Epilogue

Dirk Willem te Velde

Both the Communication and the Council Conclusions on Trade, Growth and Development respond to a growing need to address global challenges and opportunities brought about by the rise of emerging powers, lack of structural transformation in many LICs and the threats posed by climate change and natural resource scarcity. This is good timing. But is this it? And what does the European Commission (EC) need to say to report in a satisfactory way on the Communication by 2015, as required by the Council Conclusions?

As has become clear from the essays, there are a number of good points in these documents, for example:

- The identification of a number of global challenges, called a 'reshuffle';
- The recognition of some major dilemmas, such as (1) whether and how to differentiate in a heterogeneous world; and (2) whether to use trade and investment policy to address climate change and other environmental problems; and
- The formulation of good solutions such as targeted Aid for Trade (AfT) and some other possible offers in the Communication, but which are narrowed down significantly in the Council Conclusions.

The essays in this volume flag up a series of concerns, which we have grouped into five categories of risks centring around protectionism, the strategy behind differentiation, the need for Policy Coherence for Development (PCD), the importance of trade, the link to a country's growth strategy, and the need to clarify the European Union's (EU) intentions.

1. There is a major concern that the EU is moving towards protectionism

A major worry expressed by several authors (e.g. Messerlin, Erixon) is that the EU will retreat into protectionism (e.g. vis-à-vis Brazil, Russia, India, China and South Africa (BRICS)) with a range of trade-related economic policies. Clearly, the Generalised System of Preferences (GSP) reform is likely to impose more trade barriers on a range of products and countries when they are not benefiting from a reciprocal Free Trade Agreement (FTA) with the EU (Stevens, Bilal). This does not offer the best value for EU consumers (or developing country exporters). Furthermore, such threats are not confined to tariffs. The EC has issued a proposal to close government procurement markets to firms from countries that exclude European firms. Is this part of a trend in protectionist measures that many of us feared would happen in difficult economic times? Should the response not relate to how to make use of growing markets outside the EU?

2. There is no clear strategy behind the EU's approach towards differentiation, which is currently applied largely on an *ad hoc* basis

There is a clear danger that differentiation (a major issue in the Communication according to the authors in this publication) in the area of trade will be applied without consideration of economic principles and without a clear strategy that brings together the various fields in which differentiation can be applied: aid, trade, climate change, etc. (Herbert). The EU should explain the range of ultimate objectives and instruments of differentiation. For example, trade theory suggests that lower tariffs (including those applied to emerging powers) are always better, and that differentiation is a distraction. On the other hand, it is difficult to defend (on a 'needs' basis) aid to The

Group of 20 (G20) countries at the end of the decade. Moreover, environmental changes are in the hands of emerging powers, which should increasingly, and proportionally to their development stage, contribute to climate change solutions. However all of these differentiation practices interact at country level, and become a foreign policy issue in addition to an economic, environmental or development issue.

3. The Communication neglects the importance of non-trade policies for developing country growth and fails in its duty to promote PCD

There is always a danger that EC Communications are developed from one perspective at a time rather than considering the full range of issues. This Communication does not mention the full range of non-trade policies in the EU which could have an impact on developing country growth and exports. This is a missed opportunity to make other policies coherent with development goals. One example mentioned by Cantore relates to ensuring that the CAP is made coherent with development goals.

4. The EU is taking the wrong approach to the role of trade in tackling global problems

Looking ahead, there are a whole range of 21st century development challenges: food security, climate change and resource scarcity. There seems a very defensive position on the role of trade in these, even (threatening to) imposing trade barriers for green purposes (Erixon, Keane). It is important that trade and trade policy are seen as a solution to these new challenges, but this does not mean new trade barriers should be imposed. In fact, the opposite needs to occur: free trade can help countries to reap the benefits of economies of scale in green industries and can provide access to water, land and hence food, as long as there are no trade (tariff and non-tariff) barriers.

5. Trade policy has little meaning without being embedded in and linked to policies for growth

Too much emphasis is placed on the general role of trade in development in growth and too little on the underlying problems, which are context specific. The authors in this publication (e.g. Morrissey, Messerlin, Soni and Brien) comment that trade and investment policy do not have a one-to-one causal relationship with growth, and seem largely irrelevant in, for example, the Pacific.

Instead, the EU should be problem focused and examine how it can contribute, with what type of support. It could support developing country initiatives, policies and institutions for better governance (te Velde), industrialisation and diversification (Keane, Morrissey), regional integration efforts (Kingombe and te Velde) and systems to manage AfT (Basnett), as these are required to make EU trade and investment policies work for development.

So trade is not the single panacea for one single challenge, but it helps to achieve a range of policy objectives, and its role will vary enormously from one context to the next.

In addition to the above five points, there are a number of issues that will become urgent policy concerns for the EU in 2014 unless they are contained. For example, what will happen to African, Caribbean and Pacific (ACP) countries that have not signed up to an EPA or current GSP beneficiaries when they lose preferences? Or what will happen when we realise that the Common Agricultural Policy (CAP) has not been reformed despite it being economically inefficient, financially expensive and environmentally unsustainable, with alternatives available. These are all issues that should become clearer before 2015, the next milestone for the EU's trade strategy.

Indeed, by 2015, the EC needs to reports on progress on the Communication and Council Conclusions to the Council in 2015.

Our checklist of questions for the report to answer will include:

- Has the EU been able to fight protectionism and not given in to protectionist forces?
- Has the EU developed an overarching strategy on differentiation?
- Has the EU succeeded in placing trade and related policies as part of PCD and delivered step changes in PCD?
- Has the EU mainstreamed trade throughout its work on climate change and natural resource scarcity?
- Has the EU linked trade policy more properly to a country's growth strategy?
- Has the approach towards Economic Partnership Agreements (EPAs), GSP and CAP been satisfactory and not harmed relationships with developing countries?

In January 2012, the European Commission published a Communication 'Trade, Growth and Development: Tailoring trade and investment policy for those countries most in need'. It is the first on the topic since 2002, and is intended to set out a direction of travel for the next decade. Because of the potentially wide-ranging impact of the Communication, framing trade policy for a decade amidst the middle of large global shocks, we commissioned 18 essays from the world's leading trade and development experts to discuss the main issues covered.

The essays suggest there is much to celebrate in the EU documents, for example: (1) The identification of a number of global challenges, called a 'reshuffle'; (2) The recognition of some major dilemmas, such as (a) whether and how to differentiate in a heterogeneous world, and (b) whether to use trade and investment policy to address climate change and other environmental problems; and (3) The formulation of good solutions such as targeted Aid for Trade and some other possible offers in the Communication.

However, the essays also flag up a series of major concerns: (1) There is a major concern that the EU is moving towards protectionism; (2) There is no clear strategy behind the EU's approach towards differentiation, which is currently applied largely on an ad hoc basis; (3) The Communication neglects the importance of non-trade policies for developing country growth and fails in its duty to promote Policy Coherence for Development; (4) The EU is taking the wrong approach to the role of trade in tackling global problems; and (5) Trade policy has little meaning without being embedded in and linked to policies for growth. In 2015, the European Commission needs to report to the Council of Ministers on progress on the Communication. This volume of essays presents a checklist of questions that the European Commission should address.

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