

Executive Summary

1 ACP-EU Relations in a Changing World Economy

- 1.1 The increasing integration of markets for factors of production and products, driven by technological change, new systems of control and production, and the liberalisation of trade and capital markets, has generated both costs and benefits for the ACP countries. It has eroded their traditional comparative advantages in resource based and labour intensive production. At the same time, the new technologies, combined with trade liberalisation, have also opened up new production and market opportunities, both directly for exporters and indirectly for small and medium-sized sub-contractors. But in order to take advantage of these opportunities, ACP firms, particularly micro, small and medium-sized enterprises, need a network of services and support from public and private agencies. A new ACP-EU agreement needs to concentrate on developing a strategy aimed at providing this support and enabling the ACP countries to participate more fully in the world economy.
- 1.2 Trade is particularly important to the growth of output and employment in the ACP countries. On average, exports of goods and non-factor services account for 30% of GDP and, in some ACP countries, 60% of GDP, reflecting the small size of the domestic market of most ACP countries.
- 1.3 Because the comparative advantage of ACP exports lies in utilising intensively their relatively abundant factor of production, an outward-oriented strategy of development offers the possibility of combining 'growth with equity'. This will also fulfil the poverty-oriented focus of EU development co-operation, as stated in the Maastricht Treaty.
- 1.4 A key factor underpinning the continued liberalisation of world markets is the outcome of the Uruguay Round of multilateral trade negotiations. This has lowered tariff and non-tariff barriers to trade in goods and services, and strengthened the rules-based system of international trade, enhancing the degree of protection of ACP members of the World Trade Organisation (WTO) from discriminatory action on their exports.
- 1.5 It has also substantially lowered the margin of preferences for ACP countries, both as a result of the lowering and abolition of tariff and non-tariff barriers to trade, and because tariffs on the final stage of production have generally been reduced by more than earlier stages, by reducing effective tariff (and therefore preferential) rates.
- 1.6 At the same time, all members of the WTO have to accept WTO rules as a single undertaking, and, especially for ACP countries which are recent members of WTO, this implies a very substantial level of obligation. A variety of bilateral technical co-operation agreements and international organisations provide assistance to developing countries in meeting these obligations, but these are largely concerned with training individuals and preparing studies. A new ACP-EU agreement needs to assist the ACP countries in building their institutional capacity to implement their WTO obligations and explain trade rights, opportunities and

obligations to the private sector. The WTO is essentially a 'member driven' organisation and the ACP countries, both individually and collectively, also need assistance and support in monitoring, pursuing and defending their interests in the WTO.

- 1.7 The period since 1989 has seen a large decrease in the relative importance of the ACP countries in EU trade. In 1990 EU non-oil imports from the Central and East European Countries (CEEC) were one-third those of the ACP, but by 1993 they already exceeded EU imports from the ACP. EU non-oil imports from China were one-fifth less than those from the ACP in 1990 and by 1993 were twice those from the ACP. South Asian non-oil exports to the EU were half those of the ACP in 1990 and are now equal to those of the ACP countries. This represents both actual or potentially increased competition for ACP exports, but it also offers new market opportunities especially in the CEEC, ASEAN and Latin American countries, as these economies industrialise and open up their markets to international trade. It is important that a new ACP-EU Agreement enables the ACP countries to diversify their exports into these new markets. EU special preferential agreements, particularly with the CEEC and NIS countries, could be used to assist this process.

2 The Export Record of the ACP Countries and the Role of Trade Preferences

- 2.1 Sub-Saharan Africa's share of world commodity markets has fallen by 54% and that of the Pacific countries by 33% over the period 1975-93, in contrast to a 39% rise in the share of the Asian developing countries. The ACP countries' share of world production of cocoa beans has also fallen by 17%, coffee beans by 45% and palm oil and kernels by 67% over the same period of time. This, along with falling shares in EU imports, is often interpreted as evidence of domestic policy failures by the ACP countries.
- 2.2 But falling shares in world markets in cocoa and palm oil and kernels occurred *despite* a 30% and 40% increase, respectively, in ACP production. Declining shares in world markets were the result of huge increases in production and exports by Indonesia and Malaysia.
- 2.3 Commodities are subject to low price and income elasticities of demand, and the excess of world production over demand exacerbated the long run trend of falling commodity prices and export earnings instability. Over the period 1984-94, real commodity prices for all ACP commodity exports except tropical hardwoods, copper and manganese, have fallen (and 1984 prices were 27% below 1977 levels); in the case of coffee and cocoa by 10% to 11% p.a.
- 2.4 ACP countries could try and offset falling trend prices by raising productivity and there are certainly lessons to be learned from the Asian countries in achieving this. But, as we have seen, there is a potential 'fallacy of composition' in this argument in that if most major producers follow this strategy, then world prices will fall even faster and countries will simply 'invest in decline'.
- 2.5 A more promising strategy is vertical export diversification, that is, adding value by processing raw materials. For example, ACP exports of cocoa butter obtain twice the unit value of cocoa beans, and coffee concentrates etc., two and a half times the price of coffee beans.
- 2.6 The experience of the ACP countries in exporting processed primary products to the EU, however, has not been encouraging, despite preferences, with low or negative growth rates in

both volume and value and with significant instability around these trends (e.g. in coffee and cocoa products, cotton fabrics, veneers and plywood). PMDT (processing, marketing, distribution and transport) is mentioned several times as an objective in the Convention, but no concerted action has been taken both to identify problems and produce practical remedies. This should be a priority in a new Convention.

- 2.7 Sub-Saharan African countries depend on the EU market for an average of 58% of their exports, a much higher proportion than, for example, Latin America on the US market (23%). On the other hand, it is important to recognise that only ten of the SSA countries have increased their dependence on the EU market over the period 1970-1993.
- 2.8 ACP exports to non-EU markets have grown more quickly than exports to the EU; for example, exports of foodstuffs to Japan and in intra-developing country trade, ores and metals to the US and developing countries, and manufactured goods to the US. Pacific ACP countries have sharply decreased their dependence on the EU to a quarter or less of total exports, as have Dominica, Grenada and Surinam in the Caribbean. Thus, while the EU market will remain important for many ACP countries, they may well be able to increase the growth of exports by increasingly diversifying to non-EU world markets.
- 2.9 The growth of exports can also be substantially increased by diversifying exports by product. Contrary to the pessimistic view, the ACP countries have increased the proportion of non-traditional products in exports. Twenty-five ACP countries have increased the share of manufactures to 20% or more of non-oil exports. The share of non-traditional exports in non-oil exports to the EU has increased from 8% in 1987 to 13.5% in 1994, generating substantial increases in employment as well as increasing the growth of output and the supply of foreign exchange.
- 2.10 But ACP export concentration ratios are still well above comparable countries. Only 17 out of 42 ACP countries have recorded a decrease of 20% or more in their concentration ratios over the past 25 years, and only 8 countries have increased the number of products (3 digit SITC Rev.2) exported. Also, only one or two countries usually account for over 60% of non-traditional exports to the EU of any given product and export volumes are often highly variable.
- 2.11 The important conclusion of this analysis for a future ACP-EU Agreement is that supply side policies need to be considerably strengthened. Even countries like Ghana, with a good record of implementing structural adjustment policies, have found that while generally helpful, structural adjustment policies are not sufficient on their own to sustain export diversification. A new agreement must therefore provide the integrated framework of assistance required by the private sector in ACP countries.
- 2.12 Where domestic conditions have encouraged exports, then preferences can provide a useful additional incentive. This has not only taken the form of a price advantage over less preferred countries, but has also taken the form of total or partial exemption from non-tariff barriers (notably exemption from MFA quota restrictions). The development of the clothing industry in Mauritius is a particular example of a preference-induced rise in exports, but the ACP have also recorded high shares in EU imports of processed cocoa, fisheries and horticultural products, some fruits and hardwood veneers, where there has been a useful margin of EU preferences over non-ACP countries.

- 2.13 Systematic analysis of the effects of preferences, however, shows only a small positive relationship between the growth of ACP exports and the margin of preferences for fresh vegetables, and no significant relationship for fruit, processed products, cut flowers, and fisheries products. The most important single factor explaining the growth of ACP exports of non-traditional products was the growth of the EU market. Also, non-price factors such as quality and reliability are often more important than the margin of preference.
- 2.14 The trade, industrial, agricultural, financial, technical and regional co-operation provisions of a new agreement must therefore be closely integrated to assist the development of a diversified export capacity in the ACP countries.

3 Trade Co-operation in a New Convention

- 3.1 The EU has tried to defend the validity of the Lomé Convention with the GATT in terms of a combination of Article XXIV (covering customs unions) with Part IV (on Trade and Development), but this was never a credible defence and Lomé has now been placed on a GATT compatible basis by the EU, obtaining a waiver under Article XXV from the provisions of Article I. If the EU has the political will to do so, a further waiver could be granted for the period after 2000.
- 3.2 The EU has argued that a further waiver would create uncertainty and therefore undermine the benefit of a renewed Convention compared to a free trade area, but this underestimates both the security of a waiver and the possibility of challenge to an FTA.
- 3.3 A more important question is whether a renewed Convention is in the long term interests of the ACP or particular groups of ACP countries such as the Caribbean countries.
- 3.4 An ACP-EU free trade area (or areas) would create complex costs and benefits which would vary significantly between different ACP countries. The measurement of these effects is subject to a large margin of error and the most important effects are long term and a matter of informed judgement based on future development strategies.
- 3.5 Most of the benefits from an FTA can be obtained from unilateral and multilateral trade liberalisation and would avoid the trade diversion costs of an FTA.
- 3.6 An FTA must therefore offer benefits which could not otherwise be obtained through trade liberalisation, and the weaknesses in EU free trade agreements with other groups of countries raise doubts about the possibility of the ACP countries obtaining such additional benefits. Conversely, the strengthening of GATT rules and procedures and the more rapid growth of non-EU markets reinforce the importance of the ACP countries, especially in SSA, increasing their exports to non-EU markets.
- 3.7 The strengthening of GATT rules, especially the Understanding on Article XXIV, and the disputes procedures, means that the EU practice of greatly limiting the liberalisation of trade in agricultural products in its FTAs is now much more likely to be challenged and undermines the EU's assertion of the superior security of an FTA over a renewed Lomé Convention.
- 3.8 The substitution of the GSP for the Lomé Convention would, in general, result in a reduction in the present security of access to the EU market, although differences in the margin of

preferences between the EU's enhanced GSP and Lomé preferences are almost nil on industrial products and limited in the case of agricultural products.

- 3.9 This raises the option of increasing the acceptability of a renewed waiver for the Convention in the WTO and reducing the possibility of challenge, by extending the Lomé trade co-operation provisions to all least developed countries or to the wider group of developing countries (Andean and Central American) covered by the enhanced GSP. Even greater security in the WTO could be obtained by opening trade co-operation to all developing countries with a similar economic structure to the ACP (e.g. a GDP of \$50,000 million or less).
- 3.10 Regional ACP-EU agreements do not appear to be a viable option, given the heterogeneity of the various regional groupings.
- 3.11 The divergent interests of the ACP group could be accommodated through an 'umbrella' agreement' under which, for example, the least developed (UN definition) ACP countries could be covered by a renewed Convention, and the remaining ACP countries could negotiate an FTA or rely on the GSP. Alternatively, individual ACP countries could elect either to join a renewed Convention or an FTA or rely on the GSP.
- 3.12 An FTA would best be negotiated by the ACP countries acting as a group for all those interested in such an agreement, with a general timetable being agreed for trade liberalisation covering transitional arrangements over a period, which for WTO compatibility, could probably not exceed 15 years. The negotiation of such an agreement would be complex and in the meantime would probably need a WTO waiver extending the Convention for all ACP countries.
- 3.13 It is essential that the variations between ACP-EU agreements be kept to a minimum, otherwise the growth of intra-ACP trade could be harmed. It is also essential that the negotiation of an ACP-EU agreement does not distract attention and resources from the more important task of trade liberalisation by the ACP countries, binding these reforms in the WTO and integrating their economies more closely into the world economy.

4 Improving Supply Responses in ACP Countries: Government and the Private Sector

- 4.1 The conventional wisdom regarding structural adjustment is that 'get your prices right' is both a necessary and sufficient condition for growth. This report takes the view that 'getting prices right' is necessary but not sufficient. It suggests that some interventions are also required.
- 4.2 These can be divided into two categories, functional and selective. The former are those interventions which address market failures without favouring any specific activity (e.g. provision of infrastructure, institutional capacity, education), whereas the latter 'are designed to favour individual activities or groups of activities in order to remedy specific failures or externalities that would lead to sub-optimal resource allocation either in a static or dynamic sense' (Lall, 1994b, p.65). Selective interventions address a market failure concerning the creation of a dynamic capacity within an economy, in particular information and technology upgrading and skills formation.

- 4.3 Governments also have important roles to play in the co-ordination and timing of policies. This ensures that the skill creation, technological capacity and know-how are developed in line with requirements. However, 'government failure' exists in developing countries, and assistance is required to help overcome the resulting problems.
- 4.4 An example of this approach is seen in Taiwan ROC where the complementarities between market mechanisms and government interventions have been very successfully exploited. The case study of Taiwan provides many important lessons for other developing countries.
- 4.5 Increased globalisation means that growth must be private sector led. This requires greater emphasis being placed on micro, small and medium-sized enterprises (SMEs). The report examines the importance and potential benefits of small firm development in developing countries, and stresses the need for a strategy rather than *ad hoc* development. This is particularly important since small firms experience greater efficiency when they operate in clusters or groups. Under such conditions horizontal and vertical links develop between enterprises. These, together with subcontracting, result in a network of formal and informal relationships which greatly enhance flexibility and speed of reaction time.
- 4.6 Any post Lomé agreement needs to target assistance towards overcoming 'government failure', and to provide assistance to support small enterprise developments.

5 Improving Supply Responses in ACP Countries: Private Sector Development with Particular Reference to SMEs

- 5.1 Governments and the EU need to demonstrate visible commitment to private sector development. ACP governments must be steadfast in their commitment and not capitulate when faced with inevitable adverse exogenous shocks. To create a workable partnership, a minimum set of governing rules and procedures that are acceptable to all parties will need to be developed and adhered to by all parties.
- 5.2 At present the CDI is responsible, within the EU, for assisting ACP countries with industrial development. It has produced a sound plan for private sector development. Its effectiveness is currently hampered by having to operate, at times, under cumbersome, centralised, bureaucratic procedures. Ways of reducing these need to be investigated. Potentially there is much to be gained by ensuring other organisations are also included, and by increasing and targeting funds towards projects, particularly in areas such as financial sector development and institutional support for SMEs.
- 5.3 More research is required into the development of environments conducive to business growth. For example, there is a need to relate the shortcomings in infrastructure with the ability to produce and market goods at internationally competitive prices, match skills with needs, and balance general and vocational training. ACP policymakers require more information. In order to obtain this, links between public and private sectors need to be strengthened.
- 5.4 Private sector led growth requires the development of a sound financial sector. In many ACP countries, financial sectors are plagued with market failures. Increased dialogue is needed to find appropriate solutions. Foreign direct investment, technology and know-how agreements are important for the creation of an indigenous research capacity. Centre-satellite systems are

a means of diffusing skills, knowledge and technology, and creating employment opportunities. More research into their potential in ACP countries would prove useful.

- 5.5 There is much to be gained from the development of micro, small and medium-sized enterprises. Under the correct conditions, they have the potential to act as an engine of growth for the manufacturing sector. A co-ordinated policy for their development is required to ensure their sustained proliferation. The challenge of any post Lomé arrangement is to ensure that:
- (a) SME development must be given priority.
 - (b) Legal and regulatory frameworks need to be upgraded to meet the requirements of SMEs.
 - (c) An efficient support system is required for ongoing, large-scale, small firm development. This includes the provision of a large range of private and public institutions and agencies, and the development of financial, supply, and export channels in research institutes, and training programmes.

6 Aid and Foreign Investment in a New Agreement

- 6.1 The ACP countries have become more dependent on EU aid (bilateral plus institutional) flows, with the EU share in total aid flows increasing from an average of 40% for the period 1983-87 to an average of 47% for the period 1988-93. Within these flows, the share of institutional aid (EDF and EIB) in total EU aid to the ACP has increased from 18% to 21%. It is therefore disturbing to note that the nominal increase in EDF 8 (1995-2000) funding was 10% less than the amount required to maintain the real value of EDF 7, despite the enlargement of the EU.
- 6.2 Despite a large increase in EU aid to the CEEC and NIS, there is no evidence, as yet, in terms of disbursements of aid that this aid has 'crowded out' aid to the ACP countries. More important factors which will make it difficult for the EU to increase aid to the ACP countries are the general budgetary pressures in the EU arising from the need to meet the requirements of the monetary union, combined with the effects of high unemployment levels, the costs of financing EU programmes (notably the CAP) and the future costs of integrating new members into the EU. It is therefore essential that existing aid flows are used as efficiently as possible.
- 6.3 Aid under the Lomé Conventions has too many objectives and instruments, with the result that only 43% of aid is freely available to finance programmes in the ACP countries, the remainder being pre-allocated for particular purposes. Independent researchers also point to deficiencies in the management of the EU aid programme and the fact that it is too big for the Commission's capacity to manage it.
- 6.4 Pressures to increase the efficiency of aid have also eroded the principle of partnership which is fundamental to the Convention and, indeed, one of its main features.
- 6.5 The complexity of Lomé aid has become, in itself, a barrier to its efficient utilisation and only a very few people fully understand its provisions and opportunities.
- 6.6 There is therefore an urgent need to simplify both the objectives and the instruments of the Convention and to concentrate on a very limited number of objectives which are complementary to the activities of the member states (fulfilling one of the objectives of the Maastricht Treaty) and which are realistic, given the limited resources available.

- 6.7 The report recommends that increasing the capacity of the ACP countries to participate in the world economy should be a central objective of a new agreement. Given that trade is wholly an EU responsibility, then this is also the most obvious area in which EU aid would be complementary to that of the member countries. As we have argued, such a strategy of development would also enable the ACP countries to combine 'growth with equity' and so also help fulfil the poverty-oriented objectives of the Maastricht Treaty.
- 6.8 Simplifying and focusing the range of policy instruments also requires the ACP to evaluate the effectiveness of existing policy instruments, notably Stabex. The existing rules governing claims under Stabex are arbitrary and can lead to a perverse allocation of funds. The funds available are also inadequate for the task. The ACP must therefore carefully evaluate the cost of Stabex in terms of the alternative uses that the funds could be put to, and, if it is decided to retain Stabex, then reform it along more rational lines and in conformity with a feasible objective (e.g. disaster relief).
- 6.9 In order to implement an integrated and co-ordinated strategy of integrating the ACP countries more fully into the world economy, we recommend that the existing separate function of the DG8, the CDI and the EIB are combined into a joint ACP-EU organisation (which could be named the ACP-EU Productivity Centre). This Centre would have at its disposal a significant proportion of the overall financial protocol and would be responsible for all matters relevant to increasing the export capacity of the ACP countries (as discussed in Chapters 4 and 5). The governing body and members of the Centre would be drawn from both the public and private sectors of the ACP and EU.
- 6.10 Flows of foreign investment into the ACP countries have, in some cases, recovered from low levels but they are still generally inadequate, especially given the importance of FDI in transferring knowledge and providing access to markets.
- 6.11 Title III, Chapter 3, of the Convention needs to be substantially revised to signal to potential investors the willingness of ACP countries to provide guarantees of treatment to foreign investors which would reduce perceived risks. Equally, the EU could provide strong investment guarantees to EU investors in ACP countries under agreed terms.
- 6.12 EU technical assistance could also be obtained to improve the institutional environment affecting foreign investors.
- 6.13 Further areas for joint ACP-EU action could include EU private investment for privatisation programmes in ACP countries, particularly in the provision of infrastructure and financial services.

7 Future Prospects for ACP Exports to the EU for Agricultural and Horticultural Products Covered by the CAP

- 7.1 Despite the Mac Sharry reforms of 1992, and the *Agreement on Agriculture* concluded in the Uruguay Round of GATT negotiations, the Common Agricultural Policy [CAP] will continue to apply high levels of border protection on third country imports of agricultural produce into the EU for the foreseeable future.
- 7.2 Products for which high levels of border protection apply include sugar, beef and veal, milk

and milk products and olive oil. Little border protection is applied to tropical products not grown in the EU, oilseeds other than olive oil, and tobacco. The Mac Sharry reforms of 1992, coupled with the limitations imposed by the *Agreement on Agriculture*, mean that the levels of border protection for cereals and rice have been considerably reduced. Under the European Commission's recent proposals in *Agenda 2000*, border protection on cereals and beef could be eliminated altogether. The levels of border protection on fruit and vegetables are often surprisingly high as a result of the minimum import price regime that applies.

- 7.3 For sugar, dairy products, olive oil, and fruit and vegetables, continued preferential access to the EU market will remain a *potentially* valuable trade concession for the EU's partners.
- 7.4 The Uruguay Round Agreements also tightened up the requirements that must be met if a free trade area agreement is to be deemed compatible with GATT. In particular, it does not seem likely that agriculture could be excluded from future agreements. However, given the CAP, a free trade area agreement between a third country and the EU would imply the adoption of the CAP, or CAP-compatible mechanisms, by that third country, to avoid trade deflection, and would imply that trade within the free trade area should take place at CAP rather than world market prices. This would impose considerable burdens upon net-food importing countries. Thus, unless these major agricultural products can be excluded from a Free Trade Area, the continued operation of the CAP militates against the replacement of the Lomé Convention by one or more free trade areas between the EU and the ACP states.
- 7.5 The EU's GSP provisions for agricultural products are potentially valuable, particularly for the 'least-developed developing countries'. A preliminary comparison of the Lomé concessions with those in the GSP indicates that there are some instances under which a 'least-developed developing country' ACP state *could* secure superior concessions under the GSP compared to Lomé.
- 7.6 The Sugar Protocol has been incorporated as a country-specific tariff quota in the schedule of commitments entered into by the EU in the context of the Uruguay Round Agreements. We are reasonably confident that country-specific tariff quotas will not be challenged in GATT, and that this tariff quota has an existence independent of the Lomé Convention, but further consideration of the implications of the recent banana panel ruling, and in particular of Article XIII of GATT, needs to be undertaken.
- 7.7 The Sugar Protocol cannot readily be improved: instead, the challenge for the ACP states is to retain the benefits it contains. The individual ACP states that benefit from the Sugar Protocol should treat the price advantage of protected sugar sales into the EU market as a windfall gain. Local producers should be encouraged to produce (to fill the tariff quotas) at costs approximating those of efficient producers elsewhere in the world, and the governments concerned should impose an export tax to ensure that this is the case. The proceeds from such export taxes should be used to provide a sustainable future income source for the country, preferably by productive investment in the wider economy.
- 7.8 For beef there seems to be little prospect that the EU will be willing to expand the ACP tariff quota beyond existing volumes; in part, because of the severe problems of over-supply on the EU's market, and in part because of the past failures of the ACP to fill the tariff quota. Furthermore, a substantial reduction in the level of EU prices is to be expected as a consequence of the European Commission's *Agenda 2000* proposals. Nonetheless, while the

EU maintains market prices for beef well in excess of those prevailing in world markets, the existing tariff quota is *potentially* of significant benefit to the ACP states, and negotiating efforts might best be directed to ensuring greater flexibility in the reallocation of tariff quota in the event of supply shortfalls. An alternative to the existing mechanisms, which would maintain the financial benefit to recipient states, would involve the free transferability of export licences between ACP states.

- 7.9 The ACP states now enjoy duty-free access for light rum, unconstrained by tariff quotas, and the tariff quota constraints on the duty-free access for dark rum are due to be abolished in 2000. Consequently there is no further concession that can be negotiated.
- 7.10 The EU's protective regime for fruit and vegetables involves minimum import prices (known as entry prices) as well as customs duties. Both customs duties and entry prices vary during the year, and there is a bewildering array of preferential access arrangements including GSP and Lomé. The ACP states should undertake an investigation to determine whether or not the entry price system is having a harmful effect on their exports to the EU. If it is, then on those products the ACP should seek to have special – lower – entry prices determined for ACP produce. If ACP states can identify products that they could export to the EU if tariff concessions were conceded, then tariff concessions on these products should also be sought. However, it is doubtful that the EU would be willing to extend significant further concessions on fresh fruit and vegetables. One over-riding consideration is the complementarity of EU and ACP production seasons. If ACP suppliers are competing with EU production, particularly with expensive 'out-of-season' EU produce, then Europe's farm lobby will be opposed to further concessions. Nonetheless, if product – and calendar – niches can be identified that involve ACP supplies that do not compete directly with EU farm production, opposition is much less likely. Indeed Europe's retailers wish to obtain good quality, competitively priced, supplies throughout the year to ensure continuity of supply on their supermarket shelves.
- 7.11 The tariff abatement on rice is conditional upon the exporting country collecting 'an export charge of an amount equivalent' to the tariff reduction. Thus, from the perspective of the trader, there is no commercial advantage to be gained from the concession: in effect, the trader faces the EU's full mfn rate, of which part is collected on export, and part on import into the EU. Set against these circumstances, the ACP export volumes are creditable. If the intent really is to increase exports, rather than simply to transfer tax revenue to the ACP, then some part of the tariff concession should be reflected in lower overall charges faced by the trader, thus encouraging exports.
- 7.12 Whilst an increase in agricultural exports, and higher export prices on sales to the EU, is of direct benefit to the ACP states, the benefits could be enhanced if those same agricultural exports were to be exported, not in unprocessed or semi-processed form, but in processed foods and other products. An important principle to establish with the EU in any successor agreement should be that where tariff concessions have been extended to the ACP states on agricultural goods, these same concessions should be carried through to processed products. This would eliminate tariff escalation, and encourage the location of processing industries in the ACP. Although this may have little practical effect at the outset, the long term development prospects of a number of countries could be enhanced.

8 The Banana Protocol

- 8.1 A special protocol of the Lomé Convention assures preferential treatment of banana exports to the EU from 'traditional' ACP exporters. These preferences are delivered by the EU's banana trade regime, which is currently challenged in the WTO. The loss of banana trade preferences could lead to the loss of the banana industry in certain ACP states, notably the islands of the East Caribbean, with far-reaching economic and political effects.
- 8.2 The EU banana regime was introduced in 1993 to replace individual member state banana trade policies after the creation of the Single European Market. The EU regime consists of a tariff quota system which guarantees duty-free access for traditional ACP supplies up to 858,000 tonnes and access at around 20% duty of 2.5 million tonnes from Latin-American exporters. Beyond these amounts prohibitive tariffs apply. Import licences are issued for the import of 'dollar' bananas with 30% of these (so-called B licences) allocated to traditional ACP traders.
- 8.3 The Lomé protocol has been successful in maintaining ACP exports, but less successful in raising competitiveness of ACP exporters. Without the preferential treatment accorded by the EU regime, ACP exports could not compete on EU markets because of high costs and variable quality compared to Latin American supplies. Certain ACP exporters, notably the Windward Islands, are highly dependent on banana exports in terms of contribution to GDP and employment.
- 8.4 The future of the Lomé protocol is under threat as a result of the WTO challenge to the EU regime. The Interim Report of the WTO panel has found against the specific mechanisms of the tariff quota and licensing system. It is uncertain whether the preferences can be delivered without these mechanisms, so preservation of the status quo is the best outcome for the ACP exporters. A preferential tariff system would not be sufficient to offset the competitive advantage of the dollar suppliers.
- 8.5 Whatever the outcome of the WTO case, it is essential to raise the competitiveness of ACP banana exports, and the trade development provisions of the Lomé protocol need to be emphasised. A smaller industry producing higher quality bananas is the likely result.
- 8.6 Diversification opportunities in the Windward Islands are limited. Competition in world markets for alternative horticultural crops is severe. Tourism development thus far has arguably contributed little to the local demand for agricultural products.