NOTES

1. Responsibility for trade in goods and increasingly services and the trade-related aspects of regulatory measures rests with the European Communities (EC) rather than the European Union (EU) – see Chapters 2 and 3. For ease of exposition, however, we refer to the EU's Common Commercial Policy throughout this chapter.
2. The observant reader will note that there are now only four trade articles in the Treaty where previously there were seven. The remaining three were repealed.

Chapter 25 The EU and the developing world

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The EU's economic size and its role in world trade mean that it is a key player in structuring the global economic environment for developing countries (DCs) through its aid and trade policies. EU member states are the largest trading partner of DCs, providing 23% of their imports and taking 21% of their exports. The EU and its member states provide some 55% of total official development assistance (ODA) with the EU alone providing some 10% of total ODA worldwide, making it the fifth largest donor and the second largest among multilateral donors, after the World Bank (OECD, 2002a). It also has a significant indirect influence through its active participation in international organizations which attempt to manage the world economic system. The Union's development cooperation policy is comprehensive in its approach, including trade arrangements, development assistance and political dialogue. A number of useful studies have analysed the different elements of the EU's relations with developing countries and help us to better understand the dynamics behind these relationships (Cosgrove-Sacks, 1999; Grilli, 1993; Lister, 1998; McMahon, 1998; van Dijck and Faber, 2000). Important and even radical changes are currently taking place in the EU's development policy. The purpose of this chapter is to highlight these changes and to discuss their longer-term significance.

Three themes can be highlighted at the outset. First, the economic environment in which the EU's relations with DCs are played out is changing rapidly. The most striking feature of economic growth over the past three decades has been the growing differentiation in economic performance (Table 25.1). Overall differences in GDP per capita between developed countries and DCs remain large – in 2001, average income per capita was US$26 926 in the industrialized countries but only US$1204 in the low and middle-income DCs. However, for some DC regions the gap has been narrowing rapidly. This is particularly the case for the group of Asian 'Newly Industrializing Economies' (Hong Kong, Singapore, South Korea and Taiwan) and the East Asia and Pacific region (dominated by China). These countries have pursued outward-looking development policies and have rapidly increased their share of world trade (the growth of exports from East Asia annually averaged 11.3% in the 1992–2001 period, and from China 16.0%, during a period when world trade expanded by 7%, see World Bank, 2003). The Asian financial crisis in 1997–1998 interrupted this spectacular economic performance and triggered a significant contraction of economic activity in a number of countries, although recovery in most countries of the region is now well underway.

The economic performance of Latin America and the Caribbean has been less strong. Following average 3.3% annual growth in the 1970s, the continent was devastated by the debt crisis in the 1980s which led to a 'lost decade' for development in which living standards declined. Recovery in the 1990s was weak and has been further undermined by falls in economic activity in the early years of this decade as capital flows into the region dropped sharply, reflecting investors' fears of the financial fragility of the continent in the aftermath of Argentina's default. However, its performance has still been stronger than that of either the Middle East and North Africa or Sub-Saharan Africa. In the latter sub-continent, average living standards have been contracting steadily for two decades as a result of a combination of natural disasters, slumping commodity prices, economic mismanagement, civil strife and, most recently, the AIDS epidemic. World Bank forecasts for the period to 2015 project that these differences will persist, with yearly per capita growth rates of 5.0% in East Asia and 4.1% in South Asia contrasting with 1.4% in the Middle East and North African region and 1.5% in Sub-Saharan Africa (Table 25.1). As will be seen in this chapter, the latter are the two regions on which EU development policies have a particular focus. Thus, EU development

Table 25.1 Growth of real per capita GDP by region, 1971–2015

	GDP per capita 2001 (current US dollars)	Growth (%) 1971–1980	1981–1990	1991–2000	2001	Estimate 2002	Forecast 2003–2015
World	5 260	1.8	1.3	1.2	−0.1	0.5	2.0
High-income countries	26 375	2.6	2.5	1.8	0.3	1.1	2.3
Industrial countries	26 926	2.6	2.5	1.8	0.4	1.1	2.3
Asian NIEs	16 195	7.2	5.9	4.7	−2.4	1.6	3.9
Low- and middle-income countries	1 204	2.6	0.7	1.6	1.4	1.5	3.4
East Asia and Pacific	956	4.6	5.6	6.4	4.5	5.4	5.4
South Asia	468	0.7	3.4	3.3	2.6	2.9	4.1
Latin America and the Caribbean	3 678	3.3	−0.9	1.6	−1.2	−2.6	2.4
Europe and Central Asia	2 101	2.5	0.7	−1.9	2.2	3.5	3.5
Middle East and North Africa	2 099	3.6	−0.6	1.0	1.3	0.6	1.4
Sub-Saharan Africa	454	0.5	−1.2	−0.4	0.5	0.1	1.5

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policy is required to address an increasingly disparate group of DCs, where the appropriate mixture of policy instruments is going to vary depending on the circumstances of the particular country or country grouping being considered.

Second, many of the old foundations of past EU relationships with developing countries are being swept away. These relationships were based on a mixture of trade preferences and development aid to promote trade and development in the weaker DCs, while restrictive trade measures (high protection against agricultural imports, quotas on the imports of textiles and clothing, and anti-dumping duties on the import of particularly competitive manufactured goods) and the absence of financial aid characterized EU relations with the more advanced DCs. Many DCs pursued inward-looking development strategies and were little interested in attracting private foreign investment. The liberalization of world trade and capital movements in recent years is gradually transforming these relationships.

Trade preference schemes are weakening for two separate reasons. The first is economic: trade liberalization under the auspices of GATT/WTO is reducing the value of trade preferences and the EU has been searching for new models of cooperation. The second is legal: the EU's network of discriminatory preference schemes runs counter to GATT/WTO rules on regional trade arrangements but for years the EU was able to persuade other WTO members to condone them. In the mid-1990s, it decided it would no longer seek to make an exception of these arrangements and instead would enter into WTO-compatible trade arrangements with its developing country partners. These are required to be free trade areas covering substantially all trade between the contracting parties. Thus the EU has been actively pursuing regional trade agreements with many DCs, seeking to convert its selective preferential agreements into free trade ones.

Third, EU development cooperation policy is also evolving rapidly. Private capital flows have come to dwarf the role of development aid as a source of investment capital in DCs. In the face of growing dissatisfaction with the outcome of aid programmes and growing 'aid fatigue', the search has been on to define new roles for aid and to see where it can be used most effectively. The EU has undertaken a comprehensive re-evaluation of its development cooperation policy objectives which has placed poverty alleviation at the centre. The challenge now is to follow through on that commitment. Another issue is that EU development cooperation policy has been characterized by a strong regional emphasis with particular groups of partner countries such as the African, Caribbean and Pacific (ACP) states, Asia and Latin America (ALA) countries, the Mediterranean countries and, more recently, PHARE and TACIS countries (these are the countries of Central and Eastern Europe and the Former Soviet Union, respectively; see Section 25.2.2). These regional arrangements are usually conducted within an overall framework that includes trade preferences along with development assistance and political dialogue. There is a continuing tension between those who stress the regional approach based on recognition of historical and strategic linkages with former European colonies and neighbouring countries, and those who argue for a more global approach concerned predominantly with poverty reduction.

The most long-lived and comprehensive of these regional arrangements has been the relationship with the ACP countries, originally under successive Lomé Conventions and now under the Cotonou Agreement. The Lomé Convention, originally signed in 1975, was hailed at the time as a model for a new type of development partnership between industrialized countries and DCs. Its innovations of partnership, deep trade preferences and long-term contractual aid commitments were certainly novel at the time. However, the EU's geographical priorities have been rapidly changing in the 1990s following the end of the Cold War and reflecting the changing importance of different DC regions in international trade. Priority is now given to the stability and development of neighbouring countries and to aid for countries in crisis in the regions nearest to the EU. The ACP countries are no longer as central to EU development cooperation policy as was once the case. Given that these countries remain among the poorest and least-developed in the world, these shifts and realignments have generated considerable controversy and debate.

This chapter explores the way the EU interacts with the DCs through both its trade and development cooperation policies. Section 25.1 concentrates on the trade arrangements intended to benefit DCs and Section 25.2 on the development cooperation or financial aid arrangements. Section 25.3 concludes by highlighting some of the main issues in the current debates on the EU's relations with the developing world.

25.1 Trade policy

Trade is a key mechanism for development. At the multilateral level, trade policy can contribute to ensuring a fair and equitable trading system which facilitates the integration of DCs into the international trading regime at their own pace. At the EU level, trade policy can facilitate access to EU markets by lowering trade barriers through multilateral liberalization and preferential schemes. EU trade policy can also influence the DCs' own trade policies through economic and trade cooperation agreements and by encouraging regional arrangements between themselves.

25.1.1 Developing countries in WTO

At the multilateral level, the EU supports the principle of special and differential (S&D) treatment for DCs in the application of the various WTO Agreements. S&D treatment refers to the exceptions, flexibility and extra support that DCs need in order to get the most out of WTO. The two aspects most commonly cited are the right to access (particularly preferential access to northern markets without the requirement of reciprocity) and the right to protect (specifically, the right to maintain import protection on infant industry or balance of payments grounds). More recently, given the greater complexity of the Agreements negotiated in the Uruguay Round, more emphasis has been put on granting longer transition periods and providing assistance to DCs to implement the commitments they have undertaken.

The Doha Ministerial Declaration launching the Doha Development Round of WTO trade negotiations in November 2001 recognised that S&D treatment is an integral part of WTO Agreements. It noted that many DCs were dissatisfied with the way in which S&D provisions in these Agreements had operated, and it called for a review of these provisions 'with a view to strengthening them and making them more precise, effective and operational'. The EU has made a number of proposals to address this mandate. It has proposed a joint commitment from all industrial economies and the most advanced DCs to grant tariff-free treatment by 2003 to essentially all products exported by the least developed countries (LDCs), thus replicating its own 'Everything But Arms' proposal (see below). It also committed to support institutional capacity-building in DCs both to assist in the implementation of past commitments and in preparing for future trade negotiations. Many DCs are at considerable practical disadvantage in participating in WTO processes and negotiations, due to their lack of skilled personnel and the high cost of maintaining a delegation in Geneva (where the WTO is located) to deal with trade matters.

25.1.2 Preferential trade arrangements

EU preferential arrangements for DC exports have been of two kinds: a non-reciprocal Generalized System of Preferences (GSP) available to all DCs and special non-reciprocal preferential schemes for particular groups of countries. The two most important special schemes are the trade preferences under the Lomé Convention (now the Cotonou Agreement since 2000) with 77 ACP countries and those with the Community's neighbours in the Southern and Eastern Mediterranean. Non-reciprocity means that DCs are not required to offer similar preferential access to their markets in return for the access privileges they are granted to the EU market. The schemes differ in the extent of the products covered, their contractual basis and the size of the concessions offered. Together, they form a hierarchy of preferences with the ACP signatories to the Lomé Convention in the most preferred category, the Mediterranean countries in an intermediate category and most ALA countries in the least preferred category with GSP preferences only. Winters (2000) and McQueen (2002) provide a discussion of the motivation of the EU and its partners in entering these preferential trade arrangements.

Two controversies have always surrounded the operation of these trade preferences. The first has been legal. Preferential market access breaches the key principle of the GATT/WTO of non-discrimination, which means that all contracting parties to the GATT, and now members of the WTO, are entitled to receive most-favoured-nation (MFN) treatment. Interpreted literally, this prohibits discriminatory trade arrangements such as customs unions (CUs) or preferential trade areas (PTAs). A special clause was therefore

included in the GATT (Article XXIV; see Appendix 1.1, p. 20) to permit countries to participate in CUs or free trade areas (FTAs) in which they provide reciprocal preferences to each other, provided certain conditions were met. Subsequently, an additional provision known as the Enabling Clause which granted a waiver for autonomous tariff preferences to DCs was adopted in 1971 for a ten-year period and renewed as part of the final outcome of the Tokyo Round of GATT negotiations in 1979 for an indefinite period. This legitimizes the grant of general non-reciprocal preferences to DCs, and further allows deeper preferences (further discrimination) in favour of LDCs. However, the EU's special preferential schemes are not covered by the Enabling Clause as they are not granted to all DCs nor to all LDCs, but to sub-sets of them. The EU therefore had to seek a waiver in the GATT/WTO to be able legally to offer these preferences. Following the high profile 'banana dispute' in WTO in the 1990s in which the preferential market access of ACP countries was disputed by a group of Latin American banana-exporting countries, the future of these waivers became increasingly uncertain. The EU has therefore moved to convert its preferential trade arrangements with the ACP and Mediterranean countries to free trade agreements. Not surprisingly, this insistence on reciprocity of trade concessions has been controversial, not least because of the EU's continuing reluctance or inability to offer free access in the agricultural sector because of the operation of the Common Agricultural Policy (CAP; see Chapter 20).

The second controversy surrounding the EU's preferential trading schemes has been economic and concerns the value of the preferences offered to the recipient countries. This debate runs at two levels: whether the preferences themselves have been worthwhile and whether they have had any impact in promoting the trade and development of the beneficiaries. Many economists have pointed out that the EU's GSP scheme, in particular, has been so hedged with restrictions as to nullify many of the concessions offered. The EU responded to these criticisms by considerably revising its GSP scheme in 1995 and by introducing its 'Everything But Arms' proposal in 2001 which in principle provides duty- and quota-free access for all LDC exports except for arms and ammunition. The debate on the lack of impact of these schemes is driven particularly by the poor performance of the ACP countries which has seen a dramatic fall in their share of the EU market despite having the most generous market access arrangements. The remainder of this section examines these PTAs and the changes that are taking place.

25.1.3 The Generalized System of Preferences

The EU introduced its GSP scheme in 1971. It covered all DC manufactured exports and some agricultural and food products. The list of the latter was gradually extended over time, but all products covered by a CAP regime are excluded. GSP products are divided into sensitive and non-sensitive categories. Originally, non-sensitive products were offered duty-free access while the preferences for sensitive products were characterised by quotas and ceilings, thus limiting the quantities involved. The included agricultural products enjoyed only limited tariff concessions, mainly to maintain a higher margin of preference for the EU's more preferred ACP and Mediterranean partners.

In the 1995 revision of its GSP scheme, the EU did away with quotas and replaced them with tariff preferences that vary according to the sensitivity of the products. Of a total of 10 300 products, 2 100 face zero MFN duties and of the remaining 8 200 products, approximately 7 000 are covered by the GSP (the remainder are mostly agricultural products subject to the CAP which are not covered by tariff preferences). Of these 7 000 products, 3 300 are classified as non-sensitive and 3 700 as sensitive (Panagariya, 2002).

Under the general or base GSP scheme available to all DCs (including China), the EU grants duty-free access on non-sensitive products and partial tariff preferences on sensitive products. The usual tariff preference on sensitive products is a flat 3.5 percentage points (replaced for textiles and clothing by a 20% preference margin which, on a tariff of 15%, for example, would yield a preference of 3 percentage points). For many exporters, these relatively small margins are not worth the extra paperwork involved in applying for GSP status.

The EU scheme has always provided for the 'graduation' of more competitive suppliers. This is defended by the EU on the grounds that it is intended to ensure that the preferences are targeted on those countries which genuinely need them, but it also reduces the competitive pressures on EU domestic firms. Based on certain criteria, a country may be excluded from the GSP altogether or graduated from certain products. Two criteria are applied for complete exclusion. First, the World Bank must classify the country as a high-income country for three consecutive years. Second, a development index, which measures a country's industrial development and participation in international trade relative to the EU, attains a pre-specified value. Both criteria must be satisfied (Panagariya, 2002).

Graduation from specific sectors is based on achieving a certain degree of competitiveness in the sector. Graduation may take place under one of two mechanisms: a lion's share clause and a graduation mechanism. The former applies if the EU imports of a product from a beneficiary country reach 25% of the combined imports from all beneficiary countries. The graduation mechanism is based on the specialization of the beneficiary country. A sector graduates if it reaches a certain threshold where the threshold is higher, the lower the level of development.

Additional preferences are available under social, environmental and drug trafficking clauses (the 'super GSP'). In the case of textiles and clothing, an additional 20% preference is available under these arrangements. For products receiving the flat rate preference of 3.5 percentage points under the general arrangements, the extra preference under these special arrangements is 5 percentage points. The additional incentives under the social clause are available to countries complying with so-called 'core labour standards' (see Chapter 24), while those under the environmental clause are available to countries complying with international standards on forest management (note the difference with US practice which requires countries to comply with core labour standards in order even to be eligible for GSP status under its scheme). The incentives to encourage countries to fight drug production and trafficking were initially introduced in the form of duty-free access for certain products originating in the Andean Community but were subsequently extended to some other Latin and Central American countries and, most recently, Pakistan.

LDCs always enjoyed more favourable GSP preferences than other DCs. Following the adoption of the 'Everything But Arms' (EBA) proposal in February 2001, all products from countries on the UN list of LDCs (currently 49 countries) now enter the EU market duty-free. The essential value of the EBA arrangement is that it extends duty-free access to those agricultural products which were otherwise excluded from the GSP. Apart from arms and ammunition which are the only permanently-excluded products, transition periods have been put in place for three sensitive agricultural products, namely, bananas, rice and sugar. They will be eligible for unlimited duty-free access starting January 2006, July 2009 and September 2009, respectively. In the meantime, the limited tariff-free quotas which are currently available for rice and sugar exports from LDCs will be increased annually. Although seen as the new 'jewel in the crown' of EU trade relationships with DCs, the immediate impact of the EBA has been negligible, largely because the LDCs currently export so little in the product categories liberalized. These categories accounted for around one half of one per cent of total LDC exports to the EU in 2001 (Brenton, 2003).

The EU GSP is intended to stimulate exports from DCs in three ways. First, trade is generated as improved market access makes imported goods more attractive relative to domestically-produced alternatives; this is trade creation (see Chapter 6). Second, to the extent that DCs and industrial countries are exporting similar products, preferential tariff reductions may help to switch trade to the DC supplier; this is trade diversion (see Chapter 6). From the point of view of DCs, both effects are additive and positive. Third, the GSP may have a longer-term effect to the extent that it enhances the attraction of the preference-receiving country as a site for inward foreign direct investment (FDI) seeking to export to the EU.

Generally, analysts have had difficulty in finding a positive effect of trade preferences on exports apart from the rent transfer accompanying duty-free entry of goods (rents arise because DC exporters can benefit from the remaining tariff protection to the EU market against third countries, though this depends on the bargaining power of exporting firms in the DCs *vis-à-vis* the importing firms in the EU). Preference schemes appear to have little effect in stimulating new exports. Critics point to a number of flaws with GSP schemes. Non-reciprocal preferences such as those offered by the GSP lie outside the purview of WTO rules and thus can be unilaterally modified or cancelled by donor countries at any time. This uncertainty is likely to discourage investment in beneficiary countries to take advantage of these preferences, which is meant to be one of their primary rationales. The EU scheme offers minimal concessions on sensitive products (more than half of the total) which are often those in which the DCs have a comparative advantage. In the case of textile and clothing imports, quotas have been

maintained on all significant suppliers under the Multi-Fibre Arrangement which is not due to be dismantled until 2005 (see Chapter 24). Tariff preferences on agricultural products have been very limited, mainly because of the difficulty in reconciling preferential access with the protection provided by the CAP but also, even in the case of tropical products which the EU does not produce itself, in order to protect the margin of preference provided to more preferred ACP and Mediterranean suppliers. The value of preferences is also reduced by restrictive rules of origin. Rules of origin are necessary to determine if a particular product originates in a preference-receiving country; rules which, if drawn too tightly, may make it difficult for firms from the exporting country to claim originating status and thus benefit from the margin of preferential access provided.

25.1.4 Relations with the ACP states

The relationship with the ACP states began in 1957, at the inception of the European Community, with the Yaoundé Conventions. This was followed by a series of five-year Lomé Conventions starting in 1975 following the accession of the United Kingdom to the EU. The fourth Lomé Convention beginning in 1990 was of 10-year duration, although with provision for a mid-term review in 1995. Since 2000 relations with ACP countries are governed by the Cotonou Agreement which was signed in 2000 and entered into force in 2003. This introduced significant changes in philosophy and instruments as compared to the Lomé Conventions. As noted earlier, the Lomé Conventions were based on a partnership model, deep trade preferences and contractual financial commitments. This section concentrates on the trade preferences provided while the aid element is examined in Section 25.2.3.

Under the Conventions, the EU offered duty- and quota-free access to exports from ACP countries, although again a major exception was exports covered by the CAP. However, more preferential treatment than to other countries was extended for CAP products. In addition, four commodity Protocols annexed to the Lomé Convention provided preferential access for a specified quantity of exports from a selected group of traditional ACP suppliers of bananas, rum, sugar and beef. This trade regime was extended under the Cotonou Agreement until the end of 2007.

From 1980 to 2000, ACP trade grew at the meagre rate of 0.7% annually, at a time when world trade grew by 6.0% annually. The ACP share in world merchandise trade, which was 7.1% in 1950, declined to 4.7% in 1980 and to only 1.7% in 2000 (UNCTAD, 2002). These trends are mirrored in the trade of ACP countries with the EU. Despite the fact that the ACP states were at the top of the EU's hierarchy of preferences with the most favourable conditions of access to the EU market, the ACP have become increasingly marginalized as EU trade partners over time; the share of ACP exports to the EU market has fallen by more than a half, from 8% in 1975 to 2.8% in 2000. However, exports to non-EU markets have grown more rapidly. The share of Africa's exports going to the EU fell from 60% in 1980 to 30% in 2000 while for the Pacific countries the share fell from 35% to 10% over the same period. Only the Caribbean countries increased their dependence on the EU market from 20% in 1980 to 30% in 2000 (UNCTAD, 2002).

These data are often used to argue that trade preferences have not worked, and indeed there is some support for this, but it is not the whole story. The importance of the trade preferences granted is often overstated. On average, 50% to 60% of ACP exports to the EU never received any preferences because they were non-dutiable, irrespective of source. Another 5% to 10% of ACP exports to the EU fell under the special import regulations of the CAP. Ultimately, only about 35% to 45% of ACP exports received preferences. These were mainly tropical beverages, whose demand is quite price inelastic and where demand is reaching saturation in the EU. Further, the margin of preference enjoyed by ACP states fell as the EU's MFN tariffs were cut under successive GATT negotiations for products such as coffee, cocoa and vegetable oils.

Trade preferences require a supply capacity to make them effective, and arguably economic mismanagement and supply side difficulties also limited ACP exports. But even with good economic management, ACP countries have been specialized in commodities whose market prospects have been poor, and where the deterioration in export prices has had a devastating effect on development efforts. It can be argued that trade preferences failed to promote necessary diversification. On the other hand, where progress in diversification was made, the products to benefit, such as textiles, fishery and horticultural products, were those which enjoyed a substantial margin of preference over the EU's MFN and GSP tariffs. On balance, however, ACP trade preferences have not been seen as a success, and this was one of the factors leading to their revision in the Cotonou Agreement in 2000.

In 1996 the Commission published a Green Paper to promote discussion on post-Lomé relationship with ACP states. Central to this discussion was the nature of future trade relationships. As earlier noted, the EU had to seek a waiver from GATT rules to permit it to offer more favourable market access to some DCs than to others. This principle came under sustained attack during the 'banana dispute' in the WTO, and the EU indicated right from the start of the post-Lomé negotiations that it was not willing to seek further waivers to defend its trade regime with the ACP. It therefore sought new WTO-compatible trade arrangements in the form of reciprocal free trade arrangements with ACP states.

This shift was implemented in the Cotonou Agreement. In future, trade relations with ACP countries will be based on reciprocal free trade agreements which will take the form of Economic Partnership Agreements (EPAs). EPAs will cover not only trade in goods and agricultural products but also services, and will also in addition address tariffs, non-tariff and technical barriers to trade such as competition policy, protection of intellectual property rights, sanitary and phytosanitary measures, standardization and certification, trade and labour standards, trade and environment, food security, public procurement, etc.

The Cotonou Agreement lays out the basic principles and objectives of the new economic and trade cooperation between the ACP and the EU, but does not itself encompass a fully-fledged trade regime. Negotiations started in 2002 and the new agreements are to be completed by 2008. A further transitional period for the implementation of the agreements can run up to twelve years. A waiver was granted to maintain the current ACP–EU trade regime until the end of 2007 at the Fourth WTO Ministerial Conference in Doha in November 2001.

The other novel aspect of EPAs is that the Commission intends to negotiate them with ACP countries engaged in a regional integration process, and, in the absence of exceptional circumstances, not with individual states. EPAs are thus intended to consolidate regional integration initiatives within the ACP. Possible regions to establish regional EPAs would be the Caribbean (based on the existing CARICOM), southern Africa (based on SADC, although this is complicated because South Africa negotiated its own free trade agreement with the EU in March 1999), West Africa (based on ECOWAS) and East and Central Africa (based on COMESA). The task is complicated by the overlapping membership and fragmented nature of African regional groupings (see Chapter 1).

For those countries which do not feel in a position to negotiate EPAs, alternative possibilities will be considered in 2004 'in order to provide these countries with a new framework for trade which is equivalent to their existing situation and in conformity with WTO rules'. For ACP LDCs, they can benefit from the almost-free access to the EU market through the 'Everything But Arms' proposal discussed above. For non-LDC countries, the most likely option is the EU GSP.

One long-run consequence may be the fragmentation of the ACP which could be divided into a number of different groups, each with different access conditions to the EU market. These could include the LDCs availing of EBA conditions, low- and middle-income countries negotiating EPAs (divided in turn into separate regional groupings) and low- and middle-income countries which do not want an EPA and which might be offered GSP status. Whether under this new trade framework the ACP states will be able to maintain a unified negotiating framework is an open question.

25.1.5 Relations with the Mediterranean and the Middle East

Formal relations with the countries of the South and East Mediterranean go back to the Treaty of Rome which enabled France to keep, through a special protocol, its special relationships with its former colonies, Morocco and Tunisia (Algeria was still an integral part of France at the time). The 1973 war between Israel and its Arab neighbours followed by the oil embargo led to renewed efforts for improved cooperation. The first common EU policy was the Global Mediterranean Policy (1973–1992) which involved all the non-EU Mediterranean countries except Libya and Albania. Bilateral cooperation agreements were signed covering not just trade preferences but also aid through financial protocols. The southern EU enlargement to include Spain, Portugal and Greece in the mid-1980s reduced the benefits of trade preferences particularly to the Maghreb countries (below) given the similar export patterns of the two groups of countries. The new political climate in the early 1990s following the 1991 Gulf War and the fall of the Berlin Wall led to a renewed Mediterranean Policy (1992–1996). This increased the amount of development aid and extended trade preferences, as well as extending cooperation to issues such as human rights, the environment and the promotion of democracy.

In the mid-1990s, under pressure particularly from Spain, there was an attempt to breathe new life into the Euro–Mediterranean relationship through the *Barcelona Process* or *Euro–Mediterranean Partnership*. This was launched by the Barcelona Declaration issued following a conference of the 15 EU member states and 12 Mediterranean countries in November 1995. The 12 Mediterranean partners are Morocco, Algeria, Tunisia (Maghreb); Egypt, Israel, Jordan, the Palestinian Authority, Lebanon, Syria (Mashrek); Turkey, Cyprus and Malta. Cyprus and Malta were offered EU membership in December 2002, while Libya has observer status at certain meetings.

The main aims of the Barcelona Declaration are:

- Establishment of an area of peace and stability based on fundamental principles including respect for human rights and democracy (political and security partnership).
- Creation of an area of shared prosperity through the progressive establishment of free trade between the EU and its partners and among the partners themselves in order to create a Euro–Mediterranean FTA by 2010, accompanied by EU financial support for structural reform in the partners and to help cope with the social and economic consequences of this reform process (economic and financial partnership).
- Implementation of mutual understanding among peoples and the development of an active civil society (social and cultural partnership).

The FTA is implemented through bilateral Association Agreements between the EU and nine of the Mediterranean countries which replace the earlier cooperation agreements concluded in the 1970s. Association Agreements between the EU and Tunisia, Israel, Morocco and the Palestinian Authority have entered into force. Negotiations with Egypt were concluded in June 1999 and the Agreement signed in June 2001. Negotiations with Algeria were concluded in December 2001 and those with Lebanon in January 2002. As a result of Turkey's association agreement, a CU with the EU entered into force on 1 January 1996.

As well as bilateral trade liberalization, the Mediterranean partners commit to implement regional free trade among themselves, but only limited progress has been made to date. In May 2001, four members of the Barcelona Process (Morocco, Tunisia, Egypt and Jordan) signed the Agadir Declaration under which they are aiming at establishing a FTA among themselves. Turkey must accede to all the EU's preferential agreements under its CU agreement with the EU.

The substance of each bilateral agreement follows broadly similar lines. For industrial products, the EU undertakes to remove immediately any remaining duties on imports from the partner country while the partner country agrees to phase out its duties, with different periods established for different goods, but with the objective of eliminating all duties on imports from EU countries within twelve years. For agricultural and fishery products, full liberalization is prevented by the EU CAP. Instead, the agreements provide for reduced duties on limited volumes of agricultural trade between the two partners. Like the Cotonou Agreement, the Euro-Med agreements go well beyond tariff reductions, and include provisions relating to intellectual property, services, technical rules and standards, public procurement, competition rules, state aids and monopolies. In these areas, the partner countries are expected to approximate their laws to those of the EU in order to facilitate trade.

The EU–Mediterranean Partnership has not yet fulfilled the high hopes held out at the time of the Barcelona Declaration. In the political background is the Arab–Israeli conflict and the Middle East Peace Process. The Madrid Peace Conference and the breakthrough at Oslo were major factors in making the Barcelona Process possible. Conversely, the cessation of the peace process has slowed down progress towards the objectives set out in the Barcelona Declaration.

25.1.6 Relations with Asia and Latin America

The remarkable growth of the East Asian economies in the 1980s and first half of the 1990s was reflected in a significant expansion of trade and investment flows between the EU and developing Asia. The EU–ASEAN

Cooperation Agreement signed in 1980 was the cornerstone of EU Asia policy for many years. ASEAN was never intended to develop into a PTA, but emphasized instead economic and development cooperation (see Chapter 1 on this and membership). It was not until 1994 that the Commission produced its first overall Asia Strategy paper (CEC, 1994c) which was subsequently updated in 2001 (CEU, 2001b). In 1996, at the initiative of Singapore's Prime Minister, a series of Asia–Europe Meetings was introduced which now provide the framework for political dialogue. The Asian partners include seven of the ten ASEAN countries, China, India, Japan and (soon) South Korea.

As was the case for Asia, EU Latin American policy was almost non-existent in the early years of the Union. The EU's attention was focused on Africa and no member state had a particular interest in Latin America. In the early 1970s, political contacts were maintained through meetings with the Group of Latin American ambassadors in Brussels and in 1971 Latin American countries became beneficiaries of the EU's GSP. Relations remained limited in the 1980s, partly because of the debt crisis which meant that European investors lost interest in the region, and partly because of differences on the Falkland War between the UK and Argentina, which led to the suspension of the Brussels dialogue.

Since the mid-1980s, however, cooperation has been intensifying. The EU membership of Spain and Portugal in 1986 with their traditional links with Latin and Central America provided the impetus for this. At the same time, however, Latin American countries were throwing off the old import-substitution model of economic development and beginning to open up their markets under the influence of the Washington consensus. The EU share of Latin American imports had been falling, which provided another reason for forging closer links. Formal institutional ties have been established since 1990 with the Rio Group, which now comprises all of Latin America as well as representatives from the Caribbean. Ministerial meetings have been held annually between the EU and the Rio Group since 1987. Political dialogue with the Central American countries began just a little earlier in 1984 with the San José Dialogue. Political relations with Mercosur (see Chapter 1) were institutionalized by a cooperation agreement in 1995 while political dialogue with the Andean Pact countries was institutionalized in the Rome Declaration in 1996. The first summit between EU, Latin American and Caribbean Heads of State was held in 1999 in Rio de Janeiro, followed by a second summit in Madrid in 2002, to develop a strategic partnership between the two regions. Conflict resolution, democratization and human rights, social progress and the reduction of inequality and the environment are among the themes emphasized in these dialogues.

Political dialogue with ALA countries has been accompanied by attempts to forge closer trade relations and by increasing flows of EU development assistance. Trade relations have been based on the GSP since 1971. During the 1970s, the Commission promoted trade agreements with a number of ALA countries but their substantive significance was small. They generally confirmed MFN reciprocal recognition while sometimes granting quotas under more favourable access terms for some ALA exports. As noted above, the Andean Pact and some Central American countries get more favourable GSP preferences in order to help them in the fight against illegal drugs. On the other hand, ALA countries have been the most frequent targets of EU anti-dumping actions (see Chapter 24), for instance in the textiles and clothing sector for which GSP preferences are already very restricted and where quantitative restrictions on imports apply.

The 1990s saw the initiation of a new phase in trade relations with Latin America with the initiation of discussions on association agreements with Mexico (which entered into force in 2000) and Chile (concluded in 2002). Discussion with Mercosur is continuing with a commitment to start the final phase of the negotiations in the second half of 2003. Negotiations on political and cooperation agreements are planned with Central America and the Andean Community to create the conditions for future arrangements similar to those with Mexico, Chile and Mercosur. No free trade agreements with Asian countries have been mooted as yet although a framework agreement exists to tackle non-tariff barriers to trade.

25.1.7 Evaluation of EU trade policy towards developing countries

The major thrust of EU trade policy towards developing countries is a move away from the autonomous preference-based and regionally discriminatory trade arrangements of the past to a more horizontal but differentiated policy emphasizing reciprocal free trade arrangements with low- and middle-income DCs and the duty- and quota-free access now offered to all LDCs under the EBA scheme. This shift has been driven partly by a realization that it would become increasingly difficult to gain WTO waivers for regionally discriminatory non-reciprocal preferential trade arrangements in the future, and partly by dissatisfaction on the part of the EU with the outcome of the previous non-reciprocal preferences. Also, the reduction in EU tariff barriers in successive rounds of trade liberalization has steadily reduced the advantages of preferential treatment. The EU argues that free trade agreements will have positive outcomes for the partner countries, through encouraging a more efficient allocation of resources and greater competition, and by creating a more attractive location for FDI. However, some potential drawbacks should be noted.

For the ACP and Mediterranean partners, entering into a free trade agreement is an asymmetric liberalization process. For manufacturing products, these countries already enjoyed duty-free access to the EU market (though in the case of the Mediterranean countries ceilings operated in the case of sensitive products such as textiles and clothing) so the main impact is the unilateral removal of trade barriers on EU exports entering partner country markets. While consumers and producers who will now have the possibility of importing cheaper intermediate products will benefit, many firms, particular small and medium-sized enterprises, may be forced to close with a consequent rise in unemployment. Also, the continued barriers to agricultural trade in the agreements, which is the sector where many of the partner countries have their comparative advantage, makes adaptation to the required structural changes more difficult. Some fear that a consequence of this asymmetric liberalization may be trade diversion in favour of EU exports, that is, the substitution of EU imports for cheaper products currently being supplied by third countries. This would add to the economic costs of these agreements for EU partners (for estimates of the impact on the Euro–Mediterranean partners, see the studies cited in McQueen, 2002).

Proponents of these agreements therefore emphasize the likelihood of dynamic gains, particularly that the contractual nature of these agreements will lower uncertainty by locking in trade liberalization policies in the partner countries, thus helping to attract greater FDI flows. Also potentially important are the provisions to tackle non-tariff trade barriers (NTBs) thus lowering the transactions cost of trade and reducing the impact of regulatory trade barriers. Hoekman and Konan (1999) cite the case of Egypt where the trade diversion cost of an agreement limited to conventional trade barriers would generate a welfare loss of 0.14% of GDP, but could generate significant positive welfare gains of up to 5.6% of GDP if extended to tackle NTBs which they assume would occur on an MFN basis. If liberalization were extended to services trade on an MFN basis, then these authors conclude the welfare gains could even rise to 13% of GDP but this is at best a long-run objective in the Mediterranean trade agreements. For the ACP countries, a further issue which needs to be addressed is the reduction in tariff revenues as duties on EU imports are eliminated. This could curtail government spending at the same time as support for industrial restructuring and to cushion the costs of transitional unemployment is required unless other means to broaden the tax base are found.

25.2 Development cooperation

This section examines the EU's development cooperation programme referring to the provision of development aid. *Official development aid* (ODA) is defined by the OECD Development Assistance Committee (DAC) as grants or loans to DCs provided by the official sector on concessional financial terms with the promotion of economic development and welfare as the main objective. In 2000, EU ODA stood at US$4.91 billion, making the EU the third single biggest donor after the US and Japan. Net disbursements by EU member states in 2000 were US$15.31 billion, nearly half of the total DAC volume. In addition to ODA, the EU also provides what is known as *official aid*. These are flows on aid-like terms but to countries which are not considered as DCs on the OECD list. These countries include the more advanced Central and Eastern European countries as well as Belarus, Russia and Ukraine among the New Independent States of the former Soviet Union. Such flows amounted to US$2.81 billion in

2000 compared to US$4.91 billion for ODA (OECD, 2002a).

EU development assistance policy evolved in a haphazard fashion without clear objectives or justification for many years. Its modest start was when 18 African countries, mainly ex-colonies of France and Belgium, were associated with the EU under the Yaoundé Convention (1965). UK accession to the EU raised the question of the treatment of its ex-colonies in Africa, the Caribbean and the Pacific. This led to the Lomé Convention in 1975 which over the next quarter-century determined the use of the European Development Fund (EDF) for both groups of countries. In the following year, aid resources were made available to other DCs for the first time, and in 1977 cooperation agreements were signed with neighbouring countries in the southern Mediterranean. Bilateral arrangements were subsequently made with countries in Asia and Latin America, and in the 1990s countries in Eastern Europe and central Asia gained their own regional programmes. The historical legacy of this evolution was a diffuse array of policies, budgets, administrative procedures and aid instruments. This section describes the EU ODA programme and some of the recent changes in its management, designed to make it a more efficient and effective instrument in contributing to the sustainable economic and social development of DCs.

25.2.1 EU development cooperation principles

As noted, before the Treaty of Maastricht in 1992, EU development cooperation policies had evolved piecemeal and in a fragmented fashion. The main innovation of this Treaty was to establish policy objectives for EU development cooperation and to set out how it should relate to the policies of member states. The policy objectives are stated in Article 177:

> Community policy in the sphere of development co-operation, which shall be complementary to the policies pursued by the Member States, shall foster:
> - the sustainable economic and social development of the developing countries, and more particularly the most disadvantaged among them,
> - the smooth and gradual integration of the developing countries into the world economy,
> - the campaign against poverty in the developing countries.

The Article further states that Community policy in this area shall contribute 'to the general objective of developing and consolidating democracy and the rule of law, and to that of respecting human rights and fundamental freedoms.' The emphasis on the complementary nature of Community policy implies that development aid is an area where the EU operates in parallel with the member states (in contrast to trade policy which is broadly the prerogative of the Union level alone, see Chapters 2, 3 and 24).

Article 178 establishes the important principle of policy coherence, in that it requires that 'the Community shall take account of the objectives referred to in Article 177 in the policies that it implements which are likely to affect developing countries'. Article 179 sets out that decision making should be based on qualified majority voting using the co-decision procedure (see Chapter 3). However, decisions on the EDF, an extra-budgetary arrangement designed to provide financial support to the ACP countries, are explicitly excluded from this provision and continue to be taken on the basis of unanimity.

The relationship between the EU aid programme and those of the member states is addressed in Article 180 which states:

> The Community and the Member States shall co-ordinate their policies on development co-operation and shall consult each other on their aid programmes, including in international organisations and during international conferences. They may undertake joint action. Member States shall contribute if necessary to the implementation of Community aid programmes.

The significance of this Article is that it gives the EU the legal responsibility to coordinate its own development cooperation policy and those of the member states. As noted by the OECD, this makes the EU 'a unique donor in that it plays a dual role in development, as a bilateral donor providing direct support to countries, and as a coordinating framework for EU Member States' (OECD, 2002a, p. 21).

In summary, these provisions in the Maastricht Treaty define three principles on which development cooperation policy should be based:

- *complementarity* between the development policies of the member states and the Commission;
- *coordination* between member states and the Commission in the operation of these policies;
- *coherence* of all Union policies so that they take development objectives into account.

A fourth principle was added by the Amsterdam Treaty in 1997:

- *consistency* of all external actions of the Union in the context of all external relations, including security, economic and development policies.

While the strategic focus on poverty reduction as the main development policy objective in the Treaty was welcome, this needed to be refined and made more specific for operational purposes. The diversity of the different programmes and projects supported by the EU threatened to overwhelm the institutional capacity of the Commission, both in Brussels and in the field, to manage these programmes. A more selective prioritization of what the EU should try to do was clearly desirable. These priorities were set out in the Statement on the European Community's Development Policy in November 2000 (CEU, 2000j) in the context of the Millennium Development Goals agreed by 189 countries at the UN Millennium Summit in September 2000.

In this Statement, the EU identified six priority areas for action (see box). The selection of these areas was based on where the EU could demonstrate value added and comparative advantage as compared to other donors. These are macroeconomic policies and the promotion of equitable access to social services; food security and sustainable rural development; transport; trade and development; regional integration and cooperation; and institutional capacity-building particularly for good governance and the rule of law. In addition, four cross-cutting issues were identified, namely, human rights, gender equality, protection of the environment and conflict prevention. Humanitarian assistance is an additional activity but is not a priority area for long-term development assistance (OECD, 2002a).

25.2.2 Aid volumes and trends

The EU's aid programme has continued to grow over an extended period during which many other aid donors' programmes, including those of member states, have declined. Over the past decade, net ODA disbursements by the Union grew at an average rate of 5.3% in real terms. The Union's aid programme has two distinct sources of funding: monies budgeted from the EU's own resources and contributions by member states to the EDF. Figure 25.1 shows that the growth has been largely in the budgetary contribution particularly since 1991, with EDF disbursements remaining largely static and even dipping in the mid-1990s.

A consequence of the growth in EU ODA at a time when member states' ODA has been falling is that a larger proportion of member states' ODA is now being channelled through the EU. In 1997, this figure averaged 17%, being as high as 50% for Italy but only around 5%–10% for those countries, such as Denmark, the Netherlands and Sweden, which exceed the UN target contribution of 0.7% of GNP. The Commission encouraged member states to increase their ODA contributions at the European Council meeting in Barcelona in March 2002. The combined EU members had a weighted average ratio of ODA to Gross National Income (GNI) in 2002 of 0.32%. The EU Commission target at the Barcelona Council meeting was to raise the average amount of ODA to 0.39% of GNI by 2006. This target was confirmed at the Monterrey Conference on Financing for Development in March 2002.

A feature of the EU development assistance cooperation is the importance of *geographical programmes*. These are: the Pre-Accession programme for East European Countries (PHARE); the technical assistance programme for Eastern Europe and Central Asia (TACIS); community assistance for reconstruction, development and stabilization in the Balkans (CARD); external assistance to Asia and Latin America (ALA); support to the Mediterranean and Middle East countries (MEDA); and the European Development Fund for ACP countries (EDF). Each of these programmes has its own management committee made up of the Commission and member states. There are a number of *thematic programmes* dealing with issues such as food security, poverty diseases, reproductive health, environment, NGOs, etc. Finally, the EU is the largest funding agency for *emergency and distress assistance*, much of which is channelled through ECHO, the EU's Humanitarian Aid Office. The breakdown of expenditure by type of programme and source of funding is shown in Table 25.2. This table includes official aid as well as ODA and highlights the importance of the flow of funds to the candidate

The European Union's development policy

The European Union is a major player in the development sphere. It is the source of approximately half of the public aid effort worldwide and is the main trading partner for many developing countries. This declaration expresses the Council's and the Commission's intent to reaffirm the Community's solidarity with those countries, in the framework of a partnership which respects human rights, democratic principles, the rule of law and the sound management of public affairs, and to begin the process of renewing its development policy based on the search for increased effectiveness in liaison with other international players in the development sphere, and on the involvement of its own citizens.

The principal aim of the Community's development policy is to reduce poverty with a view to its eventual eradication.

Poverty, which includes the concept of vulnerability, results from many factors. The Community is therefore determined to support poverty reduction strategies which integrate these many dimensions and are based on the analysis of constraints and opportunities in individual developing countries. These strategies must contribute to strengthening democracy, to the consolidation of peace and the prevention of conflict, to gradual integration into the world economy, to more awareness of the social and environmental aspects with a view to sustainable development, to equality between men and women and to public and private capacity-building. These aspects must be taken on board by the partner countries and included in dialogue between the State and civil society.

The Community will concentrate on six areas which have been identified on the basis of the added value of Community action and of their contribution to poverty reduction: the link between trade and development; regional integration and cooperation; support for macroeconomic policies and the promotion of equitable access to social services; transport; food security and sustainable rural development; and institutional capacity-building. Attention will consistently be given to human rights, to the environmental dimension, to equality between men and women and to good governance.

The Community's development policy concerns all developing countries. As regards the allocation of resources, the least developed countries and low-income countries will be given priority, in an approach which will take account of their efforts to reduce poverty, their needs, their performance and their capacity to absorb aid. Poverty reduction strategies will also be encouraged in middle-income countries where the proportion of poor people remains high.

The Community and its member states will coordinate their policies and programmes in order to maximize their impact. Better complementarity will be sought both within the Union and with other donors, in particular in the context of country-by-country strategies. To ensure consistency, the objectives of Community development policy will be taken into greater account in the conduct of other common policies.

The Council supports the Commission in its efforts to manage the Community's external aid more effectively. Particular roles are played by the current restructuring of the Commission's departments, by the more important place being afforded to programming, by the orientation of programmes towards results, by the development of an appraisal culture, by beginning the process of deconcentration and decentralization, and by refocusing management committee tasks towards the strategic aspects of cooperation. The simplification of the Financial Regulation and a better allocation of human resources, as requested by the Commission, must be encouraged.

This declaration on the Community's development policy is to be accompanied by a Commission action plan which will define its implementation in practice. This will be subject to constant monitoring, in particular by means of the presentation of an annual report.

Source: 'Summary' in The European Community's Development Policy, Statement by the Council and the Commission, 10 November 2000

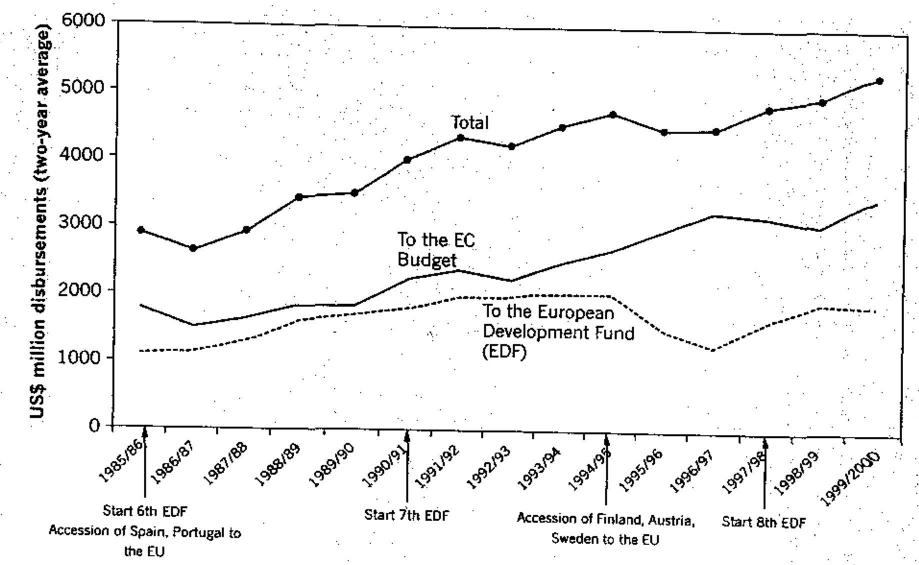

Figure 25.1 Total net ODA from the EU member states to the EC and the EDF (two-year averages (1999 prices – US$m), net disbursements)

Source: OECD (2002b). OECD©, 2002

Table 25.2 Commitments of EU funds for external relations by main instruments in 2000

Instrument	Budget		EDF	Total	%
	External Action Heading 4	Pre-Accession Heading 7			
Geographical programmes (ALA, MEDA, CARDS, TACIS, PHARE, ACP)	3 006.43	1 579.71	2 668.46	7 254.60	61.75
Structural adjustment	na	1 058.00	459.50	1 517.50	12.92
Community policies and initiatives	504.93	529.00	na	1 033.93	8.80
Food aid, refugees and emergencies	935.99	na	25.71	961.70	8.19
Unforeseen needs (losses from exports and debt relief)	na	na	455.16	455.16	3.87
Risk capital and interest rate subsidies	na	na	147.09	147.09	1.25
Other cooperation and pre-accession measures	377.72	na	na	377.72	3.22
Totals	4 825.07	3 166.71	3 755.93	11 747.70	100.00

Source: OECD (2002a) based on European Commission, Budget 2001 and EDF. OECD©, 2002

Table 25.3 Net disbursements of ODA to EU regional programmes

Programme/region	Total net ODA (current US$ m)	%	Population (million)	ODA per head (US$)
EDF	1229	26	638	1.93
Africa	1098	24	609	1.80
Caribbean	102	2	23	4.43
Pacific	29	1	7	4.29
ALA	646	14	3606	0.17
Asia	391	8	3131	0.12
Latin America	255	5	474	0.54
South Africa	128	3	42	3.05
MEDA	688	15	225	3.06
CARDS	655	14	24	26.82
TACIS	128	3	79	1.62
PHARE	43	1	2	21.78
Sub-total	3518	75	4616	0.76
Not allocated by region	1145	24	na	na
Total	4662	100		

Source: OECD (2002b). OECD©, 2002

countries in comparison to more traditional recipients of development aid.

The distribution of ODA funds to geographical programmes is shown in Table 25.3 (note that this table does not include OA funds disbursed through PHARE and TACIS). The ACP share of EU ODA, which was nearly three-quarters in 1986/87 and still one-half in 1991/92, has now fallen to just one quarter of the total. The ALA, MEDA and CARDS programmes each have roughly equal shares with about one-quarter of the total not allocated by region.

One consequence of these shifting priorities is that, in relative terms, the emphasis of EU aid on the poorest nations has diminished. In 2000, of the total ODA which could be allocated to individual countries, 26% went to LDCs and 13% to other low-income countries (39% to all low-income countries). This proportion has declined steadily since 1996 when low-income countries received 53% of gross ODA (OECD, 2002a). This shift is due to the change in the geographical priorities for EU aid. Whereas a decade previously all of the top 20 recipients of EU external assistance were DCs in Africa and Asia, in 1999–2000 the top ten recipients are in Eastern Europe and the Mediterranean (and five of these countries are not considered developing countries in the OECD classification). While this might be seen as *prima facie* evidence of aid diversion, Figure 25.1 suggests that the funds for Eastern Europe were new and additional, and that funding for the traditional beneficiaries has been maintained in absolute if not relative terms.

Nonetheless, the pattern of aid allocation has been criticized as reflecting EU geo-political interests rather poverty orientation. The European Parliament has called for 70% of EU aid to be allocated to low-income countries. The Commission's response is that the poverty focus of its programme cannot be evaluated solely on the categorization of the recipient countries by level of income (OECD, 2002a). There has also been criticism that there is insufficient poverty focus in the EU's sectoral allocations. The sectoral breakdown of 2000 ODA shows that 26% went on social infrastructure and services, 22% on commodity and programme aid, 17% on economic infrastructure and services, 13% on emergency assistance, 9% on productive sectors and the balance on multi-sector programmes, support to NGOs and administration. The European Parliament has been critical of the low proportion spent on social sector spending and has suggested a target of 35%. However, the allocation to social sectors is a poor indicator of poverty focus. This is better measured on a results-oriented basis rather than by targeting input categories. Also, setting predetermined sectoral targets for EU aid runs counter to one of the other principles of the programme, that of country ownership. Recipients do not necessarily see that the EU has a comparative advantage in supporting their social sectors, rather than providing transport or infrastructural aid.

25.2.3 The Lomé Conventions and the European Development Fund

As noted, the Lomé Convention was once the centrepiece of EU development policy and, despite its diminished status, it is worth considering in some detail for this reason. Its successor, the Cotonou Agreement, has been concluded for 20 years, with Financial Protocols for five-year periods as before. The new agreement is distinguished from the old by its more comprehensive political dimension, its emphasis on the participation of civil society and the private sector, a strengthened focus on poverty reduction, a new framework for trade and economic cooperation, and a reform of financial cooperation.

The aid component of the Convention was traditionally divided into programmable and non-programmable allocations. The *programmable* allocations were designated to individual ACP countries and regions through National and Regional Indicative Programmes. The allocation was made every five years on the basis of a formula reflecting objective criteria based on demographic, geographic and macroeconomic (GNP per capita, external debt, etc.) conditions. Once the initial envelopes were allocated, the Indicative Programmes were drawn up jointly by the recipient government and the Commission to reflect the priority areas for spending.

Non-programmable funds were generally quick-disbursing instruments and prior allocations by country were not defined. They were granted on a case-by-case basis to whichever countries met the specified conditions. The main non-programmable resources of Lomé were support for structural adjustment, STABEX and SYSMIN, and humanitarian and rehabilitation assistance. The latter two were additional to the EU budget lines that existed in parallel for the same purpose.

Aid for structural adjustment took the form of general budgetary support for public expenditure as a whole or for particular sectors in ACP countries. While linked to the structural adjustment efforts of these countries, under Lomé III (1985–1990) there were no specific reform objectives either at a sectoral or macroeconomic level. This changed radically with Lomé IV (1990–1995), under which the EU only provided import support to those countries which had signed up to a structural adjustment programme agreed with the World Bank or the IMF.

STABEX was introduced in Lomé I to compensate ACP countries for the shortfall in export earnings due to fluctuations in the prices or supply of non-mineral commodities, largely agricultural. The idea was to encourage economic development by stabilizing the purchasing power of export earnings. In the earlier Lomé Conventions, a few of the more advanced ACP countries were liable to have to repay these transfers, but subsequently they were all paid in the form of grants. STABEX was joined in Lomé II by SYSMIN, a scheme to help alleviate fluctuations in revenue arising from the production and sale of minerals. Funds could be requested by ACP countries which were dependent on mineral exports for a substantial part of their export earnings, if there were problems in the production of minerals or development projects were threatened by a substantial fall in export earnings. In addition, some Lomé funds are set aside for emergencies and rehabilitation. The level of funding available through each Convention and through the European Investment Bank (EIB) is shown in Table 25.4.

The volume of resources was not increased significantly under the new Agreement. The new Financial Protocol for the 9th EDF amounts to 15.2 billion euro, compared to 14.625 billion euro for Lomé IV bis (13.5 billion euros for the 9th EDF, plus 1.7 billion euro from the EIB). In addition, the remaining funds from previous EDFs (9.9 billion euro) are to be transferred to EDF 9 and used in accordance with the new conditions. Because funding can only begin after the Agreement is ratified, a process which was expected to

Table 25.4 Evolution of EDF and EIB resources

	1957 Rome Treaty EDF 1	1963 Yaoundé 1 EDF 2	1969 Yaoundé 2 EDF 3	1975–1980 Lomé I EDF 4	1980–1985 Lomé II EDF 5	1985–1990 Lomé III EDF 6	1990–1995 Lomé IV EDF 7	1995–2000 Lomé IV (bis) EDF 8
EDF Total	581	666	828	3 072	4 724	7 400	10 800	12 967
Grants[a]	581	620	748	2 150	2 999	4 860	7 995	9 592
Special loans	–	–	–	466	525	600	–	–
STABEX	–	–	–	377	634	925	1 500	1 800
SYSMIN	–	–	–	–	282	415	480	575
Risk capital	–	46	80	99	284	660	825	1 000
EIB own resources[b]	–	64	90	390	685	1 100	1 200	1 658
Total EDF plus EIB	581	730	918	3 462	5 409	8 500	12 000	14 625
Per capita EDF								
Current[c]	10.7	9.7	10.5	12/3	13.5	17.9	21.9	23.6
Constant[d]	62.9	50.3	41.2	31.5	22.6	24.2	24.3	23.6

[a] This includes assistance for regional cooperation, interest rate subsidies, structural adjustment assistance in Lomé IV, emergency and refugee assistance (Lomé IV) and other grants.
[b] This is a ceiling set by the board of the EIB which has never been reached.
[c] Total current value of EDF divided by associate countries' population (millions) at the beginning of each convention period.
[d] EDF totals expressed in 1997 terms; current values deflated by the EU GDP deflator index centred in the mid-year of each convention.
Source: Cox and Chapman (2000), p. 56, Table 3.4. Copyright European Communities, 2000

take two years, the Financial Protocol covers the 2000–2007 period. Although an increase in nominal terms, it represents a reduction in real terms and even more pronounced in per caput real terms, particularly if it is spread over 7 years rather than 5.

The Agreement proposes a radical revision of disbursement arrangements arising from a rationalization of the instruments of cooperation and the introduction of a system of rolling programming. In contrast to the previous Conventions, the EDF will no longer be divided into several instruments with rigid allocation systems. All EDF resources will be channelled via two instruments. One instrument will group together all non-reimbursable aid, and the other will provide risk capital and loans with a view to supporting the development of the private sector. Thus STABEX and SYSMIN have disappeared, although a new system is introduced to mitigate the losses caused by shortfalls in export earnings. The main instrument for programming grants is the *country strategy papers*. By the end of 2002 over 110 country and regional strategy papers had been prepared. These papers set out general guidelines for using the aid as well as an indicative operational programme setting out how the money will be spent.

25.2.4 Management of EU development assistance

Despite the growth in the volume of EU ODA, its management and effectiveness was severely criticized in a number of reports at the end of the 1990s. Particular attention was drawn to the following weaknesses:

- the complexity of the development cooperation system, which before the 1999 reform of the Commission under Commission President Prodi, involved five Commissioners and four Directorates General in addition to ECHO;
- the splintered framework of aid management, based around geographical programmes, meant that there was no coherent vision of aid priorities and little consistency in the weights given to the different aid elements in each geographical programme. There was a proliferation of *ad hoc* programmes, each with its own budget line, regulations and procedures which made the overall programme very inflexible;
- too much emphasis was placed on monitoring procedures and inputs and too little was placed on evaluating outputs and results. Projects and programmes rarely had performance indicators and almost no evaluations had been undertaken prior to the 1990s to document what had been achieved;
- the decision-making process was very centralized with little authority delegated to field offices. Approval of policies, regional and country strategies, individual projects and contracting was centralized in Brussels;
- staffing had not kept pace with the growth in disbursements, leading to a great reliance on external consultants for the design and implementation of projects and programmes.

A particular problem was the large and growing problem of disbursing funds which had been committed. While in 1990 outstanding commitments stood at three years annual disbursements for the EU, by 2000 this had grown to four years for EU budget funds and to six years for EDF funds (OECD, 2002a). Court of Auditors reports noted that as much as one-half of the annual budget would be committed in a rushed manner in the last month of the year. There may be good external reasons for the difficulties in drawing down funds, including the low absorption capacity of recipient country administrations, especially in ACP countries, and restrictions arising from the abuse of human rights or the breakdown of the rule of law (see below). However, internal problems, such as inadequate staff numbers to administer the programme and the large number of different budget lines and instruments, create inefficiencies and inflexibilities. Reform of the EU's aid management system was desperately needed.

The reform process was initiated when the new Commission took charge in 1999 with a restructuring of the external relations (RELEX) services. The RELEX family includes the key EU actors in foreign policy and external assistance (DG RELEX, DG DEV, DG ENLARG and DG TRADE, ECHO and now EuropeAid, see below and Appendix 3.2, p. 55, for the new designations of DGs). Under the new responsibilities, DG DEV has oversight responsibilities for the EDF programme (ACP countries) while DG RELEX has implementation responsibilities for the more politically-sensitive MEDA, CARDS and ALA programmes. DG ENLARG retains responsibility for the PHARE and TACIS programmes while ECHO manages humanitarian relief. Macro-financial assistance, including debt relief, remains the responsibility of DG ECFIN. The idea of a single External Relations Council was introduced in 2002, thus abolishing the Development Council. Development NGOS regard this as a retrograde step, fearing that development will become subordinate to foreign policy within the RELEX family.

In January 2001, EuropeAid was created to strengthen the implementation of EU development programmes worldwide and to bring consistency to programme management. EuropeAid's mission is to implement the external aid instruments of the European Commission which are funded by the EU budget and the EDF. It does not deal with pre-accession aid programmes (PHARE, ISPA and SAPARD; see Chapters 22 and 26), humanitarian activities or macro-financial assistance. It has undertaken a series of reforms to improve the efficiency and effectiveness of EU aid, including strengthening the project evaluation process and devolving project and programme management to Commission delegations in the field.

25.2.5 Strategic issues in the EU development cooperation programme

Coordination with bilateral programmes

Coordination in aid policies and programmes between the EU and member states is a legal obligation following the Maastricht Treaty, but is proving harder to achieve in practice. Policy coordination at the most basic level might include the exchange of information between donors on their current and future activities, on their experiences with project management and on their evaluation and monitoring results. At a more intensive level, it could involve agreement on development objectives or on aid strategies for individual country recipients. The EU and member states have attempted to formulate common positions in four priority sectors: food security; health and population; education and training; and poverty alleviation. However, one evaluation found only limited evidence of information exchange, with member states reluctant to share information on their activities with other donors (Cox *et al.*, 1997). It reported that a Commission study into the effect of 50 or 60 Council resolutions had found that they had very little influence on development policy making in member states. Joint country programming would appear an obvious way for different donors to agree on common strategies, but formal common country programming among EU donors is only beginning. In the absence of significant coordination of policy priorities, coordination in operational in-country programming has also made limited progress, although there was much more information exchange in programming the 9th EDF (Lehtinen, 2003). Cox *et al.* (1997) caution that coordination at country level may often be more efficiently undertaken by multilateral agencies such as the World Bank or UNDP who can also bring non-EU donors into the picture. For example, the EU increasingly aligns its development strategies at field level with the World Bank-inspired Poverty Reduction Strategy Papers for the poorest countries involved in the Highly Indebted Poor Countries (HIPC) initiative.

Complementarity

Complementarity between the EU and member state aid programmes was another principle enunciated in the Maastricht Treaty, but no guidance was provided as to how this might be interpreted. One interpretation is that it should lead to a division of labour between donors, whether on geographical, sectoral, functional or thematic lines (Cox *et al.*, 1997). Specific aid activities would be assigned to individual donors, based on their comparative advantage, proven competence in the area, etc. Possible advantages would be the creation of economies of scale and concentration of expertise in particular agencies, a reduction in unnecessary duplication of programming, and minimizing the administrative burdens on recipient countries of having to deal with multiple donors with different objectives, reporting requirements and administrative procedures even in the same sector. But the difficulties are also obvious. Donors would have to agree on the reallocation of tasks, and Cox *et al.* (1997) argue that there is little evidence on the balance of costs and benefits either for donors or recipients. They see little advantage in trying to achieve country rationalization but recommend that the EU might try to encourage greater sectoral specialization among member state donors at country level. The sectoral priorities set out for EU aid in the 2000 Development Policy Statement can be seen as reflecting the principles of complementarity in action.

Coherence

Policy coherence was the third important principle established in the Maastricht Treaty. Coherence is the need to ensure the objectives and impacts of different EU policies and agreements do not contradict or undermine each other. The OECD (2002a) report on EU aid policy highlighted some areas where the EU faces challenges in this regard. For example, while adopting a less protectionist trade policy will benefit most developing countries, some least developed countries which currently benefit from commodity protocols under the Cotonou Agreement or from the restrictions imposed on other developing countries under the Multi-Fibre Arrangement may find themselves losing out. EU agricultural policy has frequently been attacked for its adverse effects on developing world agriculture. Agriculture is usually the sector where the least liberal concessions are offered by the EU in its free trade agreements. EU subsidized farm exports have undermined local markets to the detriment of local producers in a number of documented instances including beef exports to coastal West Africa in the late 1980s, dairy exports to Tanzania, Brazil and Jamaica and canned fruit and vegetables to South Africa. The purchase by the EU of fishing rights in the coastal waters of ACP countries to support the EU's fishing industry may have a detrimental effect on local artisanal fisheries and accelerate the decline in fish stocks. To address such problems, the EU includes a section on policy coherence in each of its country strategy papers which is intended to get the right 'policy mix' for each country. However, where policy changes are required, these will inevitably meet with resistance from the EU producer interests who benefit from them.

Conditionality

Policy conditionality has been a further contentious issue in EU development cooperation policy, not least in its relations with the ACP states. In the original formulation of the Lomé partnership model, the intention was that ACP governments would identify their own priorities and jointly manage project implementation. With the growing emphasis on structural adjustment lending and policy conditionality by the Bretton Woods institutions and diminishing confidence in governance structures in many ACP states, the EU began to take a more interventionist approach. The dilemma, of course, is that a greater role for the EU in policy formulation may lead to a loss of 'local ownership' and ACP countries accepting unrealistic commitments. Implementation of conditionality has also been a problem where different donors insist on different and possibly even contradictory policy conditions, thus overwhelming the local administration.

Another important change which has increased conditionality has been the growing concern with human rights and good governance, which we have seen was enshrined as an objective of the EU's development policy in the Maastricht Treaty. All EU trade and cooperation agreements now include provisions for political dialogue, with the EU making clear that sanctions will be imposed if human rights are breached or the rule of law overturned (McMahon, 1998). Again, the most contentious debates have taken place with the ACP states. Lomé IV and particularly Lomé IV bis which began in 1996, had already introduced some provisions in this area. In the latter agreement, human rights, democracy and the rule of law were accepted as essential elements of the agreement, a legal concept which allows cooperation to be suspended. In the negotiations on the Cotonou Agreement, the EU pushed strongly for the concept of good governance as a central part of the political dialogue, with a view particularly to targeting corruption in the administration of recipient countries. The ACP states saw this as an intrusion on their national sovereignty and were reluctant to agree to what they saw as an open-ended extension of conditionality. In the end, the final compromise put into the Cotonou Agreement does not consider good governance an essential element in the above sense, but it is designated as a fundamental element which could, in certain circumstances, trigger non-execution of contracted aid flows.

25.3 Conclusions

From an aid relationship with its ex-colonies, the EU has evolved a complex set of relationships with the DCs embracing trade preferences, development assistance and political dialogue. This chapter has summarized the main features of these relationships and how they are changing over time. For reasons of space, not all aspects of these relationships could be covered. The chapter concentrated on trade arrangements and development assistance, and nothing was said, for example, about EU humanitarian aid or food aid. Both trade and development cooperation policy have been areas of dynamic policy development in recent years. Four themes in particular stand out as shaping the EU's relations with developing countries over the next decade.

First, the forging of free trade area agreements with DCs brings the EU into uncharted territory. These agreements not only require reciprocal tariff concessions from the EU's partners, but are also much more comprehensive in their scope than anything the EU has negotiated with its DC partners until now. In some cases, these negotiations have not been easy. In the case of the trade and cooperation agreement with South Africa, for example, the EU took a hard negotiating line and the final agreement has been criticized for being less than generous to South Africa. The key unresolved problem for the EU in such negotiations concerns the status of trade in agricultural products protected by the CAP, which is very often an area where the DC partner has a comparative advantage. An agreement with Mercosur, for example, is hard to envisage unless the EU is more forthcoming on agricultural trade concessions. For the DC partners, offering concessions on services and approximating regulatory provisions with EU laws will be major economic and administrative challenges. Although the potential gains are large, they are also uncertain.

Second, the changing status of the ACP countries in the EU's development policy priorities is clearly evident. The success of this grouping in maintaining a negotiating unity, when it is bound together more by historic links to the EU than by common interests, has been remarkable. But it does look an increasingly fragile unity. The EU insistence on negotiating regional EPAs will fragment ACP countries into regional groupings, leaving EDF funding and political dialogue as the only unique parts of the EU–ACP relationship. Budgetization of the EDF has long been sought by the Commission and the European Parliament, meaning that it would be programmed as part of the EU budget process rather than remain the extra-budgetary instrument it is today. If this were to occur, a further rationale for the special status of the ACP states would be removed. This is not to argue that Africa, in particular, will not remain a central concern for EU development cooperation policy, but this may be justified more by the latter's poverty alleviation mandate than by historical sentiment.

Third, successive enlargements have had a significant influence on the orientation of EU development policy and the next enlargement is not likely to be different. UK entry in 1973 shifted the focus from Africa to Asia, while Spanish and Portuguese membership raised the profile of Latin America. The traditional aid links of the countries of Central and Eastern Europe have little in common with the regional orientation of current EU members, and they are likely to have a greater interest in cooperation with south-eastern Europe, the Caucasus and central Asia. The accession countries currently provide no more than 0.03% of their GDP on development cooperation, only one-tenth the average for OECD members. Even making a proportionate contribution to the EDF, which is financed by contributions from the member states, would imply a substantial rise in their development cooperation spending. Unless there is a prior agreement on burden-sharing, these countries may be reluctant to support further increases in the volume of aid resources.

Fourth, the internal management of EU aid policy will continue to be a matter for debate. Although great strides towards improved coordination have been made, the allocation and effectiveness of EU aid remain controversial issues. The growing emphasis on policy conditionality has introduced a much stronger political element into development policy. Strengthening its poverty focus, in line with the objectives of development policy introduced by the Treaty of Maastricht, will be one of its major tasks in the coming decade.