european community BACKGROUND INFORMATION

EUROPEAN COMMUNITY INFORMATION SERVICE 2100 M Street NW, Washington DC 20037 phone (202) 872-8350
New York Office: 277 Park Avenue, New York, N.Y. 10017 phone (212) 371-3804

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BACKGROUND NOTE

PROPOSED EC GUIDELINES FOR NEW THIRD WORLD AGREEMENT

The Commission of the European Community has sent the EC Council of Ministers proposals for a new flexible five-year Association agreement with developing countries, to replace the 19-state Second Yaoundé Convention and the tri-state Arusha Convention when these expire January 31, 1975.

The Commission's memorandum sets as the main objective of the next agreement the "economic and social development of the Associate States."

In addition to present Associates, 20 Commonwealth countries in Africa, the Caribbean, and the Indian and Pacific Oceans and some other sub-Sahara African countries*/ will also be offered the right to associate with the Community.

The memorandum says that the Caribbean and Pacific groups may prefer to associate with the Community through regional groups of their own distinct from those of the African states.

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* Those not belonging to the present conventions or to the Commonwealth are: Ethiopia, Liberia, Sudan, [ex-Spanish] Equatorial Guinea and [ex-French] Guinea.

The Community, according to the Commission, must "respond even more than in the past to the expectations of all the developing countries." The proposed enlargement in the number of Associate States marks a "turning point in Community policy on development cooperation." The Community should now also assist cooperation among the Associates themselves, particularly in Africa.

In a response to criticisms of the Yaounde Conventions by potential Associates, the memorandum calls for a "real dialogue," taking "full account of the attitudes and proposals" of the developing countries. There is to be "no limitation of their sovereignty, either internal or external, nor in their freedom of choice of objectives or means for their development policy. To become an Associate does <u>not</u> mean joining the Community."

The memorandum answers a frequent American reservation on Yaounde II when it recommends that acceptance by the Associates of the mutual free trade area proposal should "not entail any obligation to grant preferences to the Community." The Associates would retain complete tariff autonomy in their relations with third countries.

The Commission says that the Community should increase financial aid substantially, adding, "Anything else would penalize present Associates, or give differential treatment to future partners: neither is a tenable hypothesis."

The memorandum asks the Council to reach a negotiating position not later than August of this year. However, it also recommends that the Community should be prepared to consider requests by developing countries to join the negotiations later, if they have not made up their minds by August.

Trade Features

Results of the Yaounde Conventions have failed to come up to expectations in the trade sector, the memorandum admits. It quotes figures to show that Associate exports to the Community approximately doubled to $1.638 billion between 1958 and 1971, after dipping from a ceiling of $1.863 billion in 1970. This represents a growth trend of 6.2 per cent a year, compared to an annual growth of 7.7 per cent in exports by all developing countries to the Community during this period. Community exports to the Associates more than doubled to $1.401 billion during the 13-year period -- an annual growth rate of 6.5 per cent, compared to 5.7 per cent for EC exports to the developing countries taken together.

The memorandum says that the problem of the instability of tropical export earnings cannot be resolved simply by stabilizing prices or "concentrating on quantities." The Yaounde Association's failure to solve the payments problems of the Associates is "all the more regrettable and disturbing as parallel developments on an international scale have been equally disappointing," the Commission says. While foreign financial assistance to these countries is essential, it cannot cope with the needs of short-term economic growth. So far, the memo says, financial aid has usually failed to offset the consequences of unstable export earnings.

Says the report: "Against an economic background as unfavorable as this, it is understandable that the existing and potential Associate States have called on the Community to introduce interim or supplementary formulas in the form of agreements of a geographically more restricted nature." The memo calls on the Community to initiate "hitherto untried methods which may serve as an example for relations between developed and developing countries."

Generalized Preferences

The Commission recalls that at the Paris Summit last October the Community undertook to improve its generalized preference system. It notes that the multilateral trade negotiations scheduled for this year aim to bring about tariff reductions. This could "lead to a shrinking of the preferences enjoyed by the Associate States," it says, adding: "the Community will have to take steps to revitalize and improve the commercial content of the Association, unless it wishes to see a large part of its commercial importance whittled away, with the additional risk that within 15 years the Association will have ceased to be a framework for an effective overall policy of cooperation in the development field."

The Community is the main trading partner of the present Associates and of all or most countries likely to apply for membership in the new, proposed Association. The enlarged, nine-member Community buys about two-thirds of the exports of the present Associates, which in turn buy 64 per cent of their imports from the Nine. The Commission believes that despite efforts to diversify tropical exports and to seek new markets -- "a process which should be encouraged" -- no major changes in the foreign trade patterns of developing countries are to be expected in the short or medium term. For this reason, the memo says, it is "important that corporations in the Associate States can rest assured that the system governing their exports to the Community will remain as liberal as possible. The free trade system offers a much broader solution in this respect than a system of generalized preferences, which for many years to come will essentially benefit the most highly developed of the developing countries and which does not cover all the products of interest to present and potential Associates."

The report notes that the only ways the Association can get around the most-favored-nation clause of the General Agreement on Tariffs and Trade (GATT) is through customs unions, free trade areas, or exceptional waiver arrangements. Associates should be required to regard the Community as an entity, guaranteed most-favored-nation treatment, except with regard to other developing countries: no commercial discrimination should be practiced among member states. If trade liberalization runs counter to the development needs of Associates, derogations should be possible.

According to the memo, "the Community is not asking its partners to accord it some form of preferential treatment. It merely wants them to apply true tariff-free arrangements that normally derive from the establishment of a free trade area. Such a system could incorporate a number of wide-ranging derogations...to allow for the development requirements of the Associate States....An Associate State can, if it so desires, extend to third countries the duty-free entry arrangements enjoyed by the Community. It may do this either unilaterally or by negotiation....Those Associates not wishing to follow such a course are perfectly free to refrain from doing so."

The Commission proposes that "the system of almost total liberalization stipulated in the present Yaounde Convention should merely be renewed. Progress should however be made with three categories of problems:

"(1) Taking the interest of associated countries into account in the preparation of measures other than tariff measures of the common agricultural policy;

"(2) Removal of excise duties on tropical products;

"(3) Protection of the description of origin of food products."

The memo recommends a flexible attitude to quantitative restrictions.

Export Receipts

The memorandum says that financial aid alone is insufficient to create a satisfactory economic growth rate in the Third World. Aid, it says, is efficacious only when applied to reasonably stable economies. The "international community" should therefore encourage the export of manufactures from developing countries and, in the short term, the "stabilization and better utilization of export receipts from trade in primary commodities."

"The problem of stabilizing export receipts of primary commodity-producing countries appears to call for solution on a world scale," the Commission says. "To date, however, the experience of world agreements on products of interest to the developing countries [coffee, tin, sugar] has not been very satisfactory."

Enlargement of the Community from six to nine nations did inevitably entail a dilution of the preferences enjoyed by present Associates, especially in regard to commodities which they export in competition with the potential Associates. The new Association should seek mechanisms for stabilizing export receipts which do not interfere with the free play of market forces, do not create obstacles to international trade, are compatible with world agreements on these products, and do not handicap the conclusion of such agreements. The memo recommends:

- fixing a reference price by product for country quotas

- guaranteeing beneficiary countries a transfer of financial resources equal to the difference between the actual value of exports to the Community and the reference value
- transfering resources in principle by means of automatic lines of credit to beneficiary countries whenever exports to the EC fall during a given period below the level of the reference value.

The Commission recommends that these credits would be repayable as soon as receipts exceed the reference value, "but only insofar as the rise in receipts is due to a world price increase and in proportion to this rise." In the case of the poorest countries, non-repayable transfers are recommended. The products which should be covered by these arrangements are sugar, peanuts, peanut oil, cotton, cocoa, coffee, bananas, and copper, the memo says.

The reference price for each product would be calculated from the world rate average of the five years preceding the applicable calendar or agricultural year. It could be accompanied by coefficients of increase which take into account the handicaps of individual beneficiary countries and the repercussions on employment.

If this year's GATT negotiations lead to reduced tariffs, the reference prices envisaged in the proposals would have to be increased, the Commission says. The reference quantities would be permanently fixed for the duration of the agreement. The net cost of the scheme should be financed from the Community's own resources.

Financial Aid

In recent years, Community aid has constituted on average one-fifth of the possible aid received by the Associates. Prior to Yaounde I, the European Development Fund (EDF) contributed 581 units of account (ua -- one ua = one 1970 dollar).

During the period of Yaounde I, EDF aid rose to 730 million ua, then to 918 million ua during Yaounde II.

Aid can now be extended to figure in contributions to the risk capital of companies -- through loans from development banks. EDF aid is planned on a five-year basis and can therefore be programmed into the development policy of each beneficiary country.

On aid, the Commission makes three main proposals:

"(1) Maintenance of the general priorities by sector as confirmed by experience" with emphasis on "economic and social infrastructure, rural development, and training.

"(2) Practical improvements to make cooperation more immediately effective.

"(3) More far-reaching and broader financial and technical cooperation."

The memorandum calls for better support for the development of small- and medium-sized concerns and the promotion of national industrial undertakings. Community aid should particularly help to train nationals of beneficiary countries to enable them to take over projects. Says the report: the concern of the Associate States to depend less and less on assistance which is sometimes difficult to control is perfectly justifiable.

The memo recommends the use of outside consultants to simplify and speed up the procedure for approving and implementing projects. In some cases, the Community should contribute management funds as well as seed money toward projects in very poor countries, the memo says.

The proposals call for increased European support for regional cooperation in the Third World, especially in the fields of transport, telecommunications, industrialization, energy, stock breeding, technical and advanced training, and trade promotion.

The Commission urges the need for the Association's European partners to act on the conclusions of the third United Nations Conference on Trade and Development (UNCTAD) regarding the special problems of the poorest Associate States. It calls for highly favorable, flexible financial conditions, and a high priority for labor problems.

The memo adds: "In view of the important role which agriculture plays in the associated countries this [labor] effort will continue to be directed first of all to the rural community. In the industrial sector, Community aid should deliberately favor branches of production which employ a large number of workers. Infrastructure projects may themselves contribute to the creation of jobs, on the condition first of all that they are implemented in such a way as to provide the maximum number of jobs, even if this apparently raises the cost of the whole operation, and secondly, that priority is given to infrastructure projects which make a maximum indirect contribution to the creation of jobs in the productive sectors."

Fast, flexible aid is recommended for profitable small- and medium-sized firms. Aid should also go to sanitary, hydraulic, educational, and small productive projects in rural communities which cannot afford the management and amortization costs of a loan, especially self-help projects.

The report criticizes the Association Council [in which the EC and the Associates have parity of representation] for having failed to discuss in sufficient depth the general guidelines of financial and technical cooperation and says that the Commission's annual survey of development aid should in the future be more detailed.

The memorandum adds: "Implementation of the EDF-financed projects must in itself contribute to the development of firms in the Associate States. To this end, the Community may already grant, in particular cases, a price preference of up to 15 per cent to supplies from firms in the country concerned or in other associated countries in the same region...It is worthwhile to generalize this provision: the preferential margin would automatically apply to all offers of supplies coming from any Associate. It should also be remembered that the International Bank for Reconstruction and Development operates in this way and inserts such a provision as a general clause in all its financing contracts."

Calling for substantially increased financial aid to the Associate States, the memo recommends more 40-year loans with a grace period of 10 years and an interest rate of 1 per cent - 0 per cent for the poorest Associates. When the final borrower is not the Associate State but a firm or local authority, two-tier loans would be offered, with the usual more favorable terms for the State and individually decided terms for the final borrower.

All Community development assistance should be part of the general budget, especially from 1975 onward when this budget will be financed from its own receipts. This evolution, the proposals say, has been recommended by the European Parliament and has the support of the Commission.

In final recommendations the report says the smooth running of the Association requires three minimum obligations:

- non-discriminatory treatment between member states in investments, related capital movements and current payments
- most-favored nation treatment except where this prejudices regional cooperation
- the agreement of all parties to authorize payments resulting either from free circulation of goods as provided by the Association, or from provisions for financial and technical cooperation.

The Commission recommends further study of the special problems of bringing Botswana, Lesotho, and Swaziland into the Association, in view of their membership with South Africa in the Southern African Monetary and Customs Union.

The Commission has submitted a separate proposal for investment guarantees, with more favorable conditions for the developing countries; host countries would have to conclude protection or equivalent agreements with the Community.

The memorandum recommends that the Association Council should be kept at ministerial level, with annual meetings, but that day-to-day decision-making procedures "should be made more flexible."

ERRATUM: Readers should note that our Background Note numbered 9 of April 20 on the EC approach to GATT negotiations should be Number 10 and that our Background Note Number 10 on Europe's social situation should be Number 11.