European Union Trade Policy and the Poor. Towards Improving the Poverty Impact of the GSP in Latin America

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Summary

The purpose of this policy paper is to analyse and propose ideas about how the European Union could have a greater impact on reducing poverty in Latin America through its trade policy, in conjunction with other policy instruments. To do this, the authors analyze the experience of the EU's Generalized System of Preference (GSP), a scheme aimed to help poor countries adapt to the international trading system. Overall, this regime has not proven effective for this purpose nor is there any evidence that it has had a significantly positive impact on reducing poverty in developing countries in general or in Latin America. This paper starts with an overview of the context affecting this issue, including a review of the literature on the link between trade and poverty, an analysis of the contemporary situation in Latin America, focusing on poverty and inequality, reasons why it is important to look at the GSP presently, this region's trade and development experience and overall ties between the EU and Latin America. The second section of the paper begins with a review of EU trade policy towards developing countries, stressing the GSP. Following that, it analyzes how the Latin American countries have used the GSP, with what results and what obstacles. This general treatment is complemented by two case studies, Bolivia and Costa Rica, which illustrate the problems more specifically. The final chapter provides conclusions and policy recommendations that should be taken into consideration in the current process of reform of the GSP.

Resumen

El objetivo de este documento de trabajo es analizar y proponer ideas sobre cómo la Unión Europea podría tener un mayor impacto sobre la reducción de la pobreza en América Latina a través de su política comercial, junto con otros instrumentos de política. Para hacer esto, los autores analizan la experiencia del Sistema Generalizado de Preferencias (SGP) de la UE, un esquema que tiene la intención de ayudar a los países pobres a adaptarse al sistema internacional de comercio. En general, este régimen no ha sido eficaz para este fin ni existe evidencia de que haya tenido un impacto significativo y positivo en la reducción de la pobreza ni en todos los países en desarrollo ni en América Latina en particular. Este estudio empieza con una visión general del contexto alrededor del tema, incluyendo una revisión de la literatura sobre el vínculo entre el comercio y la pobreza, un análisis de la situación actual en América Latina orientado hacia la pobreza y la desigualdad, las razones por las cuales es importante estudiar al SGP actualmente, la experiencia comercial y de desarrollo de esta región, y los lazos generales entre la UE y América Latina. La segunda sección del texto comienza con un repaso de la política comercial de la UE hacia los países en desarrollo, enfocado en el SGP. A continuación se analiza como los países latinoamericanos han utilizado el SGP, con qué resultados y obstáculos. Se complementa este tratamiento general con dos estudios de caso, Bolivia y Costa Rica, que ilustran los problemas con mayor detalle. El capítulo final incluye conclusiones y recomendaciones de política que deben tomarse en cuenta en el actual proceso de reforma del SGP.

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Introduction

The international trading system is currently in a state of flux, being a cause of concern for many countries, especially for those in developing regions. Multilateral negotiations in the World Trade Organization (WTO) have not advanced as rapidly as hoped, and a number of bilateral and regional trade liberalization deals –i.e., the Free Trade Area of the Americas (FTAA) and the European Union (EU)-Southern Common Market (Mercosur) Association Agreement— are also in difficulties. This situation seems to reflect several conflicts at present. The main difficulty has to do with how to liberalize commerce, not so much as whether this should be done. For some, trade should be as free as possible, while others argue that many countries and particularly poor groups in those nations are not prepared for such liberalization and that there ought to be ways to take into account their special conditions. In other words, trade rules should take more account of different development levels and needs.

That was, indeed, the main reason why the Generalised System of Preferences (GSP) was created over 30 years ago. As such, the GSP is probably one of the longest lasting tools for development policy that the European Union (and other Quad members) has at its disposal, and there are no serious plans to eliminate it in the near future. In fact, the current regulation was extended one more year and the European Commission launched a policy reflection process with a Communication (EC, 2004e) in July 2004 aimed at approving a new 10-year regulation by mid 2005. Despite this, it is a trade policy instrument that is considered by many to be "a 'second-best' arrangement that may also divide developing countries" (UNCTAD, 2003: ix). This state of opinion has a lot to do with the general lack of information about how it functions, and what has been its development impact[1]. As a result, as one author noted, "the value of trade preferences as a tool of development is uncertain" (Lister, 1997: 122). Another recent evaluation by trade economist William Cline (2003: 68) is even more damning: "few would disagree that the GSP has fallen far short of the original hope that it would be a major vehicle for development… its benefits have been meagre."

Equally controversial has been the long-running and largely rhetorical debate over whether trade is more important than aid in international efforts to promote development. Within this context, preferential schemes are often, mistakenly, considered by pro-trade advocates to be a quasi-aid instrument (because they are non-reciprocal and preferential), while aid supporters see them as little more than a marginally positive trade policy tool. The problem with the first opinion is that it ignores the difficulties poor countries face in taking advantage of the global trading system. As a recent UNCTAD (2003: ix) report on preferences notes, "there remain substantial MFN tariffs on many developing country exports, and preferences continue to have value in increasing export opportunities". Another way of looking at this is that "the existence of a preference is better for its beneficiaries, *ceteris paribus*, than its non-existence" (Stevens and Kennan, 2004a: 1).

The second view is also arguably short-sighted since there is limited evidence that preferences have had a significant effect on development in most countries in the South[2]. The indicator most commonly used to measure the performance of the GSP, the rate of utilisation (GSP imports/GSP-eligible imports), does not provide sufficient information to determine its overall impact, let alone how it affects poverty, the ultimate goal of all EU development policy instruments, including trade policy (see CEC 2000 and 2002).

Could it be, then, that the Generalised System of Preferences is more of a "symbolic policy" designed to placate those complaining about lack of access to rich country markets without making too many sacrifices on key interests in the EU (i.e. protecting certain sectors)? After all, the GSP was created for political *and* developmental motives, yet it often seems the first predo-

[1] The European Commission itself admits there are "difficulties for a quantitative assessment of the system" (EC, 2004e: 4).

[2] As noted in this project's background paper prepared by Andrew Mold (2003), an exception to this is South Korea which was able to use trade preferences very effectively, but this was during a completely different global context. Today, the conditions are less favourable.

minate. This was evident in the "reform" of the preferences in the 1990s when a special scheme was created for Andean countries affected by the problems of illegal narcotics trafficking[3]. The political nature of this tool was again seen when Pakistan was added to the list of beneficiaries of this "Super GSP" (or "GSP drugs") scheme, largely as a result of pressures from the United States in the aftermath of the 11 September 2001 terrorist attacks[4]. To a certain extent, the Commission's latest communications on this scheme (EC, 2004e; 2004f) attempt to tackle this deficit by increasing the objectivity of criteria, making it more transparent and focusing the new scheme on "sustainable development".

These considerations are part of the broader context for this policy paper which deals with the impact of the EU GSP regime on poverty in Latin America. More specifically, the objective of this document is to contribute to the policy debate regarding how EU development policy towards the region, and in particular, the GSP regime, can be improved so as to enhance the overall impact on poverty reduction.

Over the past decade, the European Union has increasingly addressed the link between trade policy and development on a general level, but the GSP does not seem to be a significant element in its policy debates[5]. The focus of this paper is on the relatively poorer and smaller countries in the Andes and Central America which are less integrated into the international economy, receive limited foreign investments and are more dependent on aid than their neighbours (although Paraguay, a Mercosur member state, is also considered as its economic conditions are similar and its land-locked situation make it especially vulnerable). They are also beneficiaries of the "GSP Drugs" arrangements, which should be particularly useful for promoting exports to the EU. In addition, for this group of Latin American states, in the short to medium term the GSP is the only special trade instrument offered by the EU; free trade agreements are not a clear option for some years to come, as was confirmed at the EU-Latin American and Caribbean Summit in Guadalajara, Mexico in late May, 2004. Since these countries are the most vulnerable in the region, they should at least benefit more clearly from trade preferences, if they are to advance in the struggle against poverty. However, the available evidence suggests the GSP has not been very useful for them.

This policy paper was prepared by the *Asociación de Investigación y Especialización sobre Temas Iberoamericanos* (AIETI) with the support of the European Community Poverty Reduction Effectiveness Programme (EC-PREP)[6]. It is a result of over eight months work by the project team[7], involving a thorough review of the literature, policy documents and available statistics, a study visit to EU institutions and Latin American diplomatic representations in Brussels[8], the preparation of a background paper (Mold, 2003) as well as policy briefs in three Latin American countries by local

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[3] This is officially called the "Special arrangements to combat drug production and trafficking". The "GSP Drugs" arrangements provide duty-free access for all industrial products included in the general arrangements and some agricultural products included in those arrangements as well as some others not included. It covers approximately 90% of imports from the Andean countries. For some products the margin of preference is significant, making it worthwhile to apply these arrangements, providing other criteria (i.e., rules of origin) are met.

[4] Not surprisingly, with regard to the application of the GSP "graduation clause", Trade Commissioner Pascal Lamy (2003) denies political determinants in a note of December 15, 2003, saying "this decision taken is not of a political nature". The argument used is that only economic criteria were used to graduate "sector V" in Colombia's exports to the EU.

[5] In fact, in a presentation of an earlier version of this report at the Commission in early 2004, one functionary asked the project director whether he was asking too much from the GSP in considering its poverty relevance. Furthermore, the Communication mentioned earlier (EC, 2004e) does not even make an effort to make an explicit link between the GSP and the fight against poverty.

[6] AIETI is a non-profit research centre based in Madrid, Spain whose work is oriented towards promoting European Union co-operation for Latin American development. EC-PREP Project EP/R03/07 was approved in June 2003. EC-PREP is financed by the Department for International Development (DFID) of the Government of the United Kingdom and is managed in collaboration with the European Commission. For more information, see: www.ec-prep.org.

[7] In addition to the Project Director, Christian Freres, and the Principle Researcher, Andrew Mold, two others provided research support for this activity: Karina Pacheco (former researcher at AIETI and currently professor at the University of Cuzco, Peru) and Knud O.v.d. gentschen Felde (former research intern at AIETI and presently a graduate student at the London School of Economics).

[8] The authors thank staff members from the Commission, from the European Parliament and from several Latin American embassies for their time and consideration in out research trip in October 2003: for reasons of confidentiality, their names and posts are not included.

specialists[9], a research workshop including several external experts[10], and feedback from European Commission staff at a briefing in February, 2004[11].

The paper is organised in two parts, including six chapters, in addition to this introduction and a chapter with conclusions and policy recommendations. The first part, consisting of chapters 1-5, establishes the overall context, both in terms of concepts and the basic situation of the preferential regime, EU- Latin American economic ties and the trade-poverty nexus.

Chapter 1 synthesizes some key findings from the literature and empirical studies on the link between trade and poverty. The second chapter provides an overview of Latin America's current situation, providing some arguments for why the EU ought to focus more on this region. In Chapter three an in-depth explanation is given for why it is a good moment to analyse the GSP in general and specifically with regards to Latin America and how it impacts on poverty in this region.

Following that, the fourth chapter reviews this region's development and trade challenges. The fifth chapter, last in the first part of the paper, surveys the Community's ties with Latin America, in particular in the economic sphere.

The second part of this policy paper includes its main contributions in terms of research and analysis on the effects of the GSP in Latin America. It begins (Chapter 6) with a summary of EU trade policy towards developing countries. The main chapter of this section and the paper as a whole (Chapter 7) analyses in some depth Latin America's experience with the GSP. It includes two case studies (Bolivia and Costa Rica), with broader lessons for this preferential regime.

Finally, the project's main findings are summarised in the conclusions, which also develops a series of general and specific policy recommendations.

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[9] In that regard, we would like to acknowledge the work of Napolean Pacheco, Director of the *Fundación Milenio* (La Paz, Bolivia); Alcides Hernández, Professor at the *Universidad Nacional Autónoma de Honduras* (Tegucigalpa, Honduras); and Ramiro Rodríguez, Associate Researcher, *Centro de Análisis y Difusión de la Economía Paraguaya* (Asunción, Paraguay).

[10] Special thanks are due to the following people who generously contributed their time to this project: Stephen Szepesi, researcher at the European Centre for Development Policy Management (Maastricht, Netherlands); Ricardo Lagos, European representative for the Central American Economic Integration Bank/BCIE (Brussels, Belgium); José Antonio Sanahuja, Professor at the Universidad Complutense de Madrid and Coordinator of the Development and Cooperation Department at ICEI (Madrid); and Camilo Tovar, researcher, European External Policy Advisors (Brussels, Belgium).

[11] The authors of this study are grateful to Commission staff for participating in this meeting and providing useful feedback and critical suggestions which were incorporated into later drafts.

1. The context

1.1. TRADE AND POVERTY: A SET OF COMPLEX LINKAGES

In a period when budgetary restrictions have become tighter, and the amount of foreign aid to developing countries has been stagnant or declining, preferential market access agreements have become increasingly popular among the Quad countries (Canada, the European Union, Japan and the United States) as a tool for helping the poorest devellopping countries. Their popularity stems from two basic characteristics of market access agreements. The first is that, in budgetary terms, no explicit item has to be included *ex-ante*. Rather, the cost is assumed *ex–post*, in terms of the loss of tariff income on imports. In a period of budgetary restraint, this advantage is an important one. Secondly, against a backdrop of "aid fatigue", it is now widely believed that developping countries can benefit more from opportunities to increase their exports than aid "hand-outs." It is commonly implied that market access agreements like the European Union's "Everything But Arms" initiative which provides free market access to the European market for the 49 least developed countries, have a potentially greater on poverty reduction than traditional aid programmes.

Unfortunately, there is little systematic empirical evidence to support this contention. Trade preferences and poverty reduction is one of those difficult interface issues where there is a notable lack of empirical studies. Most existing research into the links between trade regimes and poverty has focused on the relationships between trade liberalisation and poverty[12]. Neoclassical models based on the Stolpher-Samuelson theorem assume that increased exports promote poverty reduction and diminish income inequalities. According to this view, an expansion of labour-intensive exports in poor countries raises the demand for unskilled labour and thus reduces the wage differentials between skilled and unskilled labour. Nonetheless, this is an incorrect generalization for most Latin American countries, where the abundant factor in most countries of the region is not unskilled labour but rather some natural resource, and labour skills in the region rank at an intermediate level on a world scale. More pointedly, endemic inequality in Latin America has meant that trade liberalisation has had little impact on the poor. Indeed, as Cornia and Court (2003: 18) observe, "contrary to the experience of East Asia, recent trade liberalisation in Latin America has been associated with increased wage inequality".

Exhaustive reviews of the literature tend to dwell on how the influx of imports changes relative prices, and how the poor adjust to the subsequent macroeconomic and sectoral shocks[13]. The implication is that poverty levels are conditioned principally by the passive response of the poor to trade liberalisation. Relatively little attention is paid to how the poor actively take up the greater opportunities to export. Moreover, there has been a tendency to treat trade as a homogenous variable, when in practice it is far from that. There are qualitative differences between different kinds of trade which have enormous implications for its poverty-reduction potential. For instance, commodity-chain analysis of African horticultural exports have revealed that only a very small percentage of the rents generated by the export industry are actually received by nationals, most of the profits being captured by the multinationals (Dolan and Humprheys, 1999). Similarly, in the case of Central American *maquila*, the amount of local value-added is extraordinarily low, reaching barely 2 percent (Buitelaar and Perez, 2000). Evidently, when linkages with the local economy are low or negligible, the poverty reduction implications are very different from when the export industry in question is deeply embedded in the local economy.

Poverty is not easily defined or described – it has many characteristics, and many causes. This is especially true in the turbulent situation in Latin America, where the incongruities and contradictions in economic and social policy over the last two decades are

[12] The European Commission (CEC, 2004), in a brochure on the Doha Development Round, admits that "it would be false to say that trade automatically leads to development, or even that trade automatically leads to growth. The process is too complex, too multi-faceted, for that".

[13] See, for instance, Winters, McCulloch and McKay (2004), Bannister and Thugge (2001), or McKay, Winters and Kedir (2000).

readily apparent. The search for a single policy instrument or paradigm in such a context is like searching for the “holy grail”: no evidence of its existence has been found. A plethora of policy instruments have been identified in the past (e.g. micro-credits) and applied in Latin America, but invariably the results have been disappointing. An explicit recognition of this is essential if the policy debate is to move forward. There is certainly a need for a class-stratified, differential approach to the analysis of trade growth and poverty reduction.

Certainly, the empirical facts suggest that simplistic relationships can be discounted. For instance, much literature has been produced in recent years on the damaging impact of agricultural subsidies in the industrialised countries on developing country agricultural markets, both because of the loss of export markets and because of the negative impact of inflows of subsidised agricultural products. But it is unclear whether cheap subsidised imports are always prejudicial to the poor For the majority of poor in heavily urbanised Latin America, a first impact of cheap subsidised imports from the North may be to reduce food expenditure and increase consumer welfare (at the expense of tax-payers in the North).

By drawing on a wide range of recent literature, UNCTAD (2004d) provide a more complete vision as to how the poverty-reducing potential of trade can be reduced. The authors stress that too much literature on the interface between trade and poverty reduction has adopted an excessively narrow focus. The analysis of trade and poverty reduction needs to go beyond the issue of trade liberalisation and take into account the following:

- the effects of primary commodity dependence;
- the balance of payments constraint on poverty reduction;
- the relationship between export and import instability and vulnerability
- the relationship between upgrading the composition of exports towards higher-quality and higher-skill products and the social exclusion of poorer producers from livelihoods
- bargaining power in global production chains and the distribution of gains from trade,
- how the development of non-traditional exports affects gender relations;
- the effects of trends in, and variability of, the terms of trade on poverty;
- the relationships between trade and employment; and
- the relationships between trade and inequality

The list is clearly a long one, and the implications of such a number of complex interrelated issues means that simple a priori conclusions are not possible.

In this context, the insights of Carter and Barham (1996) are highly relevant. Basing their analysis on three case studies (Chilean fruit, Guatemalan vegetable, and Paraguayan soybean and wheat exports), these authors observe that there has been considerable heterogeneity in the impacts of agro-exports on growth and equity in Latin America, and small farmers have often been excluded from the benefits of agro-export booms. Whereas they describe the Paraguayan experience as *highly exclusionary* (with diminished peasant land access and falling sector employment), the situation in Guatemala has been very *broadly based* (with increases in both sector employment and small-farm land access), and the Chilean boom is classified as *ambiguous* (with diminished small-farm land access, but probably increased employment in this sector). One conclusion from this is that basic social and economic inequalities have marginalised the bulk of the rural poor from being able to take advantage from the benefits of market access agreements.

Clearly, therefore, policy instruments of promoting trade have not been finely-tuned to the needs of the poor. In part, at least, excessively simple characterisations of poverty are to blame for this situation. Sender (2003) makes some very pertinent observations on this point. There is a fallacy, for instance, that the majority of the rural poor in developing countries are farmers and self-employed. The lack of capacity of these groups to take advantage of preferences like the GSP+ is thus often seen in terms of their reduced access to inputs (seeds, planting material, fertilizers and agro-chemicals, as well as credit), and a simple failure to be aware of the market access opportunities that exist. The corresponding policy advice, *pace* Carter and Barhnam (1996), is to facilitate access to inputs, credit and information. Yet the record of such schemes in the past has been strikingly poor. Sender suggests that failures like these are due to an unrealistic characterisation of the rural poor, ignoring important stylistic facts such as a majority of the rural poor tend to be poor women without education and without stable employment. Coherent with this idea, Deere and Leon (2003) stress very clearly the unequal distribution of land assets in Latin America, where in countries like Guatemala and Paraguay less than 10 percent of rural landholders are women. In such circumstances, does it make much sense to design policies which purportedly enable the poor to take advantage of market access opportunities, when the relevant and most needy populations may not be in a position to take advantage of such opportunities?

Table 1
Relative Growth Performance between Regions (GDP per capita, 1961-2002)

	1961-1970	**1971-1980**	**1981-1990**	**1991-1995**	**1996-2000**	**2001-2**
East Asia & Pacific	2.6	4.6	5.6	8.3	4.5	5.2
High income: OECD	4.4	2.6	2.5	1.2	2.3	0.4
Latin America & Caribbean	*2.5*	*3.5*	*-0.8*	*2.9*	*1.2*	*-1.3*
Middle East & North Africa	-	1.5	-0.8	0.9	1.4	0.6
South Asia	1.9	0.7	3.3	3.1	3.5	2.9
Sub-Saharan Africa	2.6	0.8	-1.1	-1.4	0.6	0.9
World	3.5	1.9	1.4	0.7	1.7	0.2

SOURCE: Calculations from World Bank Indicators Online data.
Simple arithmetic averages of growth rates (i.e. not weighted).

1.2. THE CONTEMPORARY SITUATION IN LATIN AMERICA. WHY THE CONTINENT DESERVES MORE ATTENTION ON THE PART OF THE EU

The remit for this project is all the more urgent bearing in mind the contemporary situation of the region. Despite (or, as some critics would have it, because of) adopting "Washington Consensus"-type policies of market liberalisation and free trade since the late 1980s and early 1990s, the results for most Latin American countries have been enormously disappointing. To a large extent, the region has not even initiated a recovery from the disastrous situation after the onset of the debt crisis[14].

Relative growth performance over the last two decades has been poor, and no evidence is emerging of a recovery (Table 1).

Indeed, over the last three years Argentina has probably already beaten Russia to the record for the highest income-per-capita drop in peacetime living memory, although this record may be short-lived ---Venezuela plunged towards an income per capita drop in 2003 which was even higher than those of Russia and Argentina (Palma, 2003: 147).

The crisis is not confined to the economic sphere. After the "*vuelta de los barracones*" in the 1980s and a rapid disappearance of the remaining dictatorial regimes in the continent, confidence in democratic solutions to social and economic problems is at dangerously low ebb. A recent survey of the *Lati-*

[14] The debt crisis in particular had a profound and deeply damaging impact on the long-term prospects for poverty reduction in the region, a crisis from which most countries have yet to recover. In the aftermath of the First World War, John Maynard Keynes made an eloquent declaration concerning how it would be a dangerous folly to impose punitive reparations on Germany ("The Economic Consequences of Peace"). Yet it is a little recognised fact that, as a share of GDP, the negative net transfer of financial resources from Latin America was even larger than that of Germany after World War I (Palma, 2003). In this context, the subsequent failure to recover from the debt crisis is less surprising.

noBarómetro, a poll covering 17 countries in Central and South America, reveals that 52% of the Latin American's surveyed agreed with the statement "I wouldn't mind if a non-democratic government came to power if it could solve economic problems".[15] In countries like Paraguay and Peru, close to 90 percent of the population professed that they were not satisfied with the way democracy was working in their countries. Indeed, judging by the current social and political tensions, in a number of countries in the region the situation may be reaching breaking point (e.g. Bolivia or Ecuador). The stoic capacity of Latin Americans to withstand economic hardships, insecurity and instability may be reaching its limits.

One of the greatest frustrations in this resource-rich region has been its inability to reduce poverty levels over time. According to the Economic Commission for Latin America and the Caribbean (ECLAC), 227 million Latin Americans lived in poverty in 2003. This represents some 44% of the population. Some 60 million get by on less than one dollar a day, the international standard for extreme poverty.

As Table 2A shows, despite small improvements in the 1990s, the percentage of Latin Americans living in poverty today is larger than 25 years ago. In absolute terms (see Table 2B) in 2002 there were 85 million more poor people in the region than in 1980. The share of the region's population who are considered to be the extreme poor (defined differently in each country), has remained at about the same level over the past two decades. However, in absolute terms there has been an increase of more than 30 million suffering this fate, a 50% jump between 1980 and 2002. Rural poverty has proven to be particularly immune to efforts to attack this problem.

The region is also the world champion in income inequality[16], with a GINI coefficient of 0.51 (compared with 0.37 in South East Asia and 0.29 in Eastern Europe)[17]. At the end of the 1990s, one fifth of the richest people in Latin America received three fifths of its income, while the poorest fifth had to make do with only 3% of regional income. This inequality is aggravated by other forms of social exclusion based on gender, race, age, ethnicity, etc.[18]

Poverty is not easily defined or described – it has many characteristics, and many causes. This is especially true in the turbulent situation in Latin America, where the incongruities and contradictions in economic and social policy over the last two decades are readily apparent. The search for a single policy instrument or paradigm in such a context is like searching for the "holy grail": no evidence of its existence has been found. A plethora of policy instruments have been identified in the past (e.g. micro-credits) and applied in Latin America, but invariably the results have been disappointing. An explicit recognition of this is essential if the policy debate is to move forward.

Confronted by such a situation, one position of the European Union could be that the contemporary predicament of Latin America and the plight of its poor is not particularly of its concern: trading and economic links with the region are generally low and, although migratory movements towards the EU are increasing, they are still completely overshadowed by sub-Saharan and North African immigration. Why, then, the concern for Latin America?

[15] Cited in "The Economist", 1/11/2003, "The Stubborn Survival of Frustrated Democrats", page 53.

[16] Two excellent sources on this subject are the study by Albert Berry (1997) and a recent World Bank report (de Ferrant, et al, 2003). Another recent investigation (Ganuza, et al, 2004) reviews the impact of economic liberalization in the last two decades on poverty and inequality.

[17] This figure is a regional, non-weighted average of inequality within countries.

[18] Data from the Inter-American Development Bank (IADB) document, "Inequality, exclusion and poverty in Latin America and the Caribbean" prepared for European Commission/IADB Seminar on Social Cohesion in Latin America and the Caribbean, June 2003 (http://europa.eu.int/comm/external_relations/la/sc/idb.pdf).

Table 2
Poverty in Latin America

Table 2A
Percentage share of population living in Poverty, 1980-2002 a

	Poor[b]			Extreme poor [c]		
	Total	**Urban**	**Rural**	**Total**	**Urban**	**Rural**
1980	40.5	29.8	59.9	18.6	10.6	32.7
1990	48.3	41.4	65.4	22.5	15.3	40.4
1997	43.5	36.5	63.0	19.0	12.3	37.6
1999	43.8	37.1	63.7	18.5	11.9	38.3
2000	432.5	35.9	62.5	18.1	11.7	37.8
2001	43.2	37.0	62.3	18.5	12.2	38.0
2002	44.0	38.4	61.8	19.4	13.5	37.9

Table 2B
Absolute numbers of people living in poverty, 1980-2002 (millions)a

	Poor[b]			Extremely poor[c]		
	Total	**Urban**	**Rural**	**Total**	**Urban**	**Rural**
1980	135.9	62.9	73.0	62.4	22.5	39.9
1990	200.2	121.7	78.5	93.4	45.0	48.4
1997	203.8	125.7	78.2	88.8	42.2	46.6
1999	211.4	134.2	77.2	89.4	43.0	46.4
2000	207.1	131.8	75.3	88.4	42.8	45.6
2001	213.9	138.7	75.2	91.7	45.8	45.9
2002	221.4	146.7	74.8	97.4	51.6	45.8

SOURCES: ECLAC, 2003: *Panorama Social de América Latina 2002-3* (page 50), based on household surveys of the respective countries

Notes:

a) Estimations corresponding to 18 countries in the region, plus Haiti

b) People with income below the poverty line, including those in extreme poverty

c) People with income below the extreme poverty line

If, as looks increasingly likely, the region slips into further economic, social and political crisis, as the regional hegemon, is it not essentially a problem for United States to deal with? Although the historical colonial links between Europe and Latin America run deep, since the 19th Century and the decalration of the Monroe Doctrine, the region has been firmly within the sphere of influence of the United States. The fates of the United States and Mexico are already deeply entwined, and economic and migratory links between the US and the rest of the region are intensifying. Seen from this stance, Europe has its own concerns, such as the Eastern European Enlargement or the Middle East and North Africa.

In this paper, we argue that this would be a fundamentally wrong and short-sighted position to take. In terms of contemporary priorities (and despite declarations to the contrary by the Bush administration at the beginning of its term in office), subsequent events on the international scene (particularly "9/11") have meant that Latin America has received a very low priority even from the United States. Given the apparent disinterest of US, there is a window of opportunity for the EU to make an effective and more pro-active contribution to helping resolve the problems of region. Distrustful of the overbearing influence of the United States on the region, it is moreover a contribution which would probably be welcomed by many Latin American countries themselves. Nonetheless, experience shows that policy built on the back of simple altruism does not tend to endure: identifying mutual interests is a surer way of guaranteeing the permanence of any policy solutions. There are many reasons for the EU to be concerned for the current state of crisis in which the region is immersed. Latin America should be important to the EU for both altruistic motives (the concern to achieve the Millennium Development Goals/MDGs) and self-interest (Latin America has a considerable amount of extra-EU stock of foreign direct investment (FDI), for instance).

1.3. WHY IT IS IMPORTANT TO LOOK AT THE GSP IN LATIN AMERICA NOW

Against this backdrop, there are several reasons why it is important to analyse the GSP at present. The first reason has to do with the current state of play in global trade politics. A major part of this is the crisis of WTO Doha "Development" Round, due to, *inter alia*, serious differences between rich and poor countries about what to include in (or keep out of) the agenda and what should be the pace of liberalization. Even before this current problem –which the July 2004 agreement may or may not resolve—, as a result of growing preoccupation with the plight of the least developed countries, there has been a certain resurgence of interest in preferences.[19] This has been translated into new policy initiatives, including the United States Africa Growth and Opportunity Act (AGOA) and the EU Everything But Arms (EBA) initiative, created in 2000 and 2001, respectively. Even poor nations are considering strengthening the Global System of Trade Preferences among Developing Countries (GSTP), a scheme established in 1989 (UNCTAD, 2004b).

This trend has gone against the fairly common view that free trade agreements (FTAs) are inherently more relevant than unilateral preferences and should therefore be the end goal for developing countries in their relations with the European Union. Of course, this vision ignored the fact that many of these countries were not even offered the possibility to negotiate an FTA with the EU, so for them, preferences are the only option available. In sum, given slow movement on multilateral liberalization and delays on bilateral agreements, should the EU work to improve the preferential regime for all developing countries? This seems to be one of the rationales for the recent Commission policy proposal (EC, 2004e).

A second reason is that in the past the GSP was renewed and "reformed" with little debate outside (and even inside) EU institutions. This is because it is seen, on the one hand, as a highly technical matter, and, on the other, as not very relevant when compared with the development impact of other policies; therefore, most are happy to leave it to the bureaucrats and technicians. Would it be useful to broaden the public discussion on preferences in order to strengthen their legitimacy?

The third reason is that the GSP does –or at least, it could—matter. In the period 1997-2002 about 20% of Latin American exports were able to enter the EU under this scheme; that represents close to 47 billion euros in goods. As we shall see in the case studies, the GSP has helped a number of countries to diversify their export offer (see Gonzalez, 2003). According to the Costa Rican government (one of the few to analyse the socioeconomic impact of these preferences), 80% of the companies in one of the most important export sectors –plants and flowers— are small and medium enterprises; that sector is closely linked with the fight against poverty and exclusion since it employs many women and immigrants. The Colombian cut flower industry is another example of a sector which expanded thanks to these preferences. Unfortunately, information on a broader variety of sectors and specific products in the whole region is not available, so it is difficult to come up with definitive conclusions on the poverty impact of the GSP.

However, we do know that, despite improvements in the conditions introduced in this scheme over this period (through the December 2001 Regulation), for the Latin American countries the value of GSP imports declined almost thirty per cent in absolute terms. The utilisation rate (preferential imports divided by eligible imports)

[19] For instance, in March 2004 the World Bank and the WTO organized a workshop on the GSP in Geneva. UNCTAD (2003) recently published a major study on trade preferences for the least developed countries. A number of academic studies dealing with preferences have come out (Stevens and Kennan, 2004a; ODI 2004) in the past year or so.

fell only slightly, but what is particularly worrisome is that the utility rate (preferential imports divided by total imports) fell by half. Indeed, between 1997 and 2002 only in one country did this scheme present a greater level of effectiveness (Argentina), in four countries the levels remained more or less the same (Cuba, Panama, Uruguay and Venezuela), and in the majority of countries the effective usefulness of the GSP fell considerably. Overall, Latin American countries utility rate was 15% in 2002, less than one half of the total for all developing countries (33%).

Whether one argues that this problem of preference erosion is a result of Latin American incapacity to export, deficiencies in the GSP itself or increased EU barriers to access (all of which are legitimate factors), the result is the same: these economies are not reaping the potential benefits of this preferential scheme, which in turn means the poverty-reduction possibilities of this instrument are not fully realised. So, even if a significant part of the solution lies in better conditions and policies in the region, clearly another part should be dealt with through improvements in the GSP (together with other complementary policies). What sort of changes could be instituted to increase access without making the regulation more complicated and difficult to manage?

A fourth motive for reviewing the GSP at this time is that a number of problems have arisen in its application. Specifically, we refer to the "graduation clause" introduced in the 2001 Regulation (Article 12), as well as the rules of origin and the overall temporality of GSP regulations. In 2002, the Commission notified a number of GSP beneficiary countries that certain sectors would be graduated according to the criteria included in the 2001 Regulation[20]. Although this decision applied the stipulated criteria more or less correctly (this is open to interpretation), these standards seem excessively rigid, not taking into account changing economic conditions, or the possible impact graduation could have on poverty[21]. The rules of origin are criticized as being very strict, making it difficult for some producers to take advantage of the GSP. One of the most cited critiques refers to the short period covered by the GSP regulations (3 years), such that producers in developing countries have little incentive to invest in new productive sectors (Pacheco, 2003). Is it worthwhile to attempt to make technical improvements in the GSP?

The fifth reason is that special preferences that this scheme offers to the Andean and Central American nations –the poorest in Latin America— are under attack from other developing countries[22]. They see the "drugs regime" as contrary to WTO principles, providing special preferences for non trade-related aspects. Moreover, the argument presented by India in a complaint against the "GSP drugs" scheme in the World Trade Organisation (WTO) was accepted by a panel in November 2003[23].

[20] See: *Official Journal of the European Communities* (2002).

[21] The European Commission's analysis –explained in the notice cited above and in Council Regulation 815/2003 (8 May 2003)— is based on data from 1997-1999, "good years" for most of Latin American economies, while the decision to graduate certain sectors was taken in a period of economic recession (2002-2003). Surprisingly, the Regulation did exempt Argentina, Uruguay and Venezuela, three of the region's richer countries –precisely because they are in periods of deep crisis--, while targeting Colombia and Costa Rica for graduation.

[22] Most of these are in Asia which was not included in the original "GSP drugs" scheme despite the important drug trade in some countries (i.e., Afghanistan, Burma, Thailand, etc.). When Pakistan was included in the December 2001 Regulation, this set off a number of criticisms in other Asian countries, most notably India (see following note), which felt certain sectors in which it competes with Pakistan would be severely affected by this decision; its conflictive relations with this South Asian neighbour was surely another factor. However, it is important to note that criticisms have not only come from outside the region. In fact, within Latin America, the Mercosur countries (Brazil and Paraguay in particular) have voiced their disapproval of this scheme which, they claim, established an unfair discrimination within the zone based on relatively arbitrary political criteria. Moreover, in the WTO panel on the "GSP drugs" regime in 2002-2003, Paraguay openly supported India's complaint.

[23] See WTO (2003) report. In its complaint, India claimed that the special drugs scheme of the EU GSP Regulation violates the GATT "enabling clause" (1979 decision on differential and more favourable treatment of developing countries) because it is discriminatory in favour of some countries while preferences should be available to all developing countries (unless they receive a special waiver, such as that granted for the preferences provided by the EU to the ACP group). For its part, the EU argued that India had presented a narrow interpretation of the "enabling clause" which does –according to the Community—permit differing (but not discriminatory) treatment of developing countries. It also notes that the scheme responded to the special development needs of countries affected by the problems related to drug trafficking and production. Andean and Central American countries presented their own texts in a similar vein.

Although this decision was reversed by the WTO Appellate Body in April 2004, the European Commission will probably have to adapt the GSP regulation since the report found that the EU's "drugs arrangements" need to be based on objective and transparent criteria that would allow all developing countries similarly situated to qualify for these special preferences. One of the implications for Latin American nations currently benefiting from this scheme is that in its latest policy proposal, the European Commission (EC, 2004e), it did not include a special drugs regime, an acknowledgement that it would be incompatible with WTO rules.

Despite the WTO ruling, this issue is quite complex. Besides the trade-related issues which this international body dealt with, there is the matter of how preferences may affect the production of illegal drugs. Available evidence is far from clear, but much of it shows impact has not been significant in terms of reducing this illicit trade. According to one author (Cline, 2003: 89), from 1991 to 1999, coca production fell 55 percent in Bolivia and 68 percent in Peru. In Colombia, however, it rose 227 percent. In evaluating the US Andean Trade Preferences Act (ATPA), Cline argues that "the clearest instance of a link to ATPA was the increase in Peruvian exports of asparagus, a cash crop grown near traditional coca areas. In contrast, Colombian cut flowers were already a major export prior to ATPA, and have lost share in ATPA - preference imports."

The links between the EU's GSP-Drugs scheme and increased Andean exports are similarly anecdotal, although the Andean Community insists that it is one of the "main mechanisms through which the European Union contributes to the" fight against illegal drugs (Consejo Andino, 2004). In addition, this sub-regional institution argues that the erosion of preferential benefits will have a "highly negative impact on illegal trade in our countries", affecting growth, employment and development prospects. As a political argument it seems convincing, but the data supporting this claim is limited. Even so, its merits ought to be considered seriously in a debate which weighs concerns related to trade rules, development impact and the need to show visible support for the Andean efforts to deal with the drugs trade since the EU has continuously expressed its commitment to upholding the principle of "co-responsibility" (i.e., drug - consuming countries must share in the costs of fighting this problem).

This brings us to final basis for looking at the GSP: it is presently under review by the European Union, which must come up with and approve a new scheme before July 2005. In order to facilitate this process, which coincides with complex multilateral negotiations and deep internal changes in the EU itself, the Commission (DG Trade, 2003) decide to "roll over" the current GSP Regulation for one year, although the WTO ruling obliges it to implement changes in the drugs schemes by 1 July 2005. This decision was taken partially because of the uncertain fate of the Doha Development Round which had originally been expected to close before the present regulation expires, but it also reflects the EU's realization that certain aspects should be improved, and it needs time to evaluate different options. One area which requires changes is the graduation clause. According to the Commission, in the new regulation this will only be adjusted for the larger beneficiaries of the GSP in the new Regulation. This is a recognition that a small number of countries account for the largest proportion of GSP imports to the EU (see Chapter 6 for more on this).

Despite the evident need for a deep policy discussion on the GSP and its possible contribution to reducing poverty in Latin America, we are also aware that this instrument alone could never be sufficient. That is why this paper argues for a better integration of various development policy tools to achieve the goal of alleviating poverty. One of these instruments, policy dialogue, must be oriented towards helping Latin American countries create more adequate economic, social and institutional conditions to take proper advantage of the opportunities trade may offer for development. In this context, we consider that the emphasis that the EU now places on the importance of "social cohesion" in the region is a step in the right direction. It does, however, run the risk of giving the impression that, by conditioning any progress to reform in Latin America itself, the EU is shying away from undertaking a critical analysis of its own policies towards the region. These issues will be addressed in latter sections of this paper.

1.4. LATIN AMERICAN DEVELOPMENT AND TRADE. A TALE OF CONTINUOUS FRUSTRATION

It should now be clear why the issue of the Generalised System of Preferences is relevant today, but it is equally important to briefly review how Latin America has progressed, particularly in the area of international trade. This region is made up of primarily middle income countries, so it cannot be said to be the neediest area in the South. However, this perception is incomeplete and needs to be complemented by a deeper review of development reality in Latin America.

This is not the place to present an in-depth study of Latin America's development situation. However, in order to propose viable policy options it is useful to highlight some aspects which demonstrate the serious challenges the region faces.

Latin America is a paradox within the developing world. It is made up of relatively well-off countries (when compared to Sub Saharan Africa or South Asia), most of which are democracies that have been independent republics for over a century. Yet, democratic institutions in many countries remain weak and unstable. Although most of Latin America has implemented significant economic reforms over the last two decades, growth rates are insufficient to reduce poverty levels (principally because the gains are generally small, discontinuous and unequally distributed)[24]. Despite being rich in natural resources (or perhaps because of this), Latin America has not been able to expand its share of international trade; on the contrary, it has been losing out to more dynamic economies in Asia and elsewhere. Since the economic reforms and liberalisation of the late 1980s and early 1990s, Latin America has been caught in the trap of low commodity prices – although export volumes have increased quite impressively in most countries of the region, this has not necessarily been reflected in higher export earnings[25]. Generally speaking (and this is one of the major puzzles of the Latin American development dilemma), it has not lead to the creation of new dynamic sectors nor has it generated much employment, which would be key to poverty reduction (Ganuza et al, 2004). To a large extent the same can be said for the boom in foreign direct investments in the second half of the 1990s, flows which were mostly oriented to services and are also subject to wide fluctuations and tend to concentrate in a few countries. Finally, the foreign debt problem has returned to the forefront of political concerns in the region.

The causes of the poor economic performance and social outcomes of the region have been widely discussed and analysed. Some analysts blame the process of liberalisation and the adoption of Washington Consensus-type policies in the region since the 1980s debt crisis (e.g. Palma, 2003). There is certainly no hiding the poor performance of Latin America since the application of the new set of policies. In Latin America, GDP per capita grew by 75% from 1960-1980, whereas from 1980-1998 it has risen only 6%. In the case of Mexico, income per capita would have been twice as high today if it were not for the growth slowdown of the last two decades (Weisbrot, Naiman and Kim, 2000).

But the previous policies of import-substitution became unsustainable in the face of the debt-crisis.

Indeed, the import-substitution policies broke down in the 1980s, in the aftermath of the debt crisis, and Latin America returned towards a more "open" model of development. Yet, as we have seen, the subsequent results have been disappointing. Contrary to the expectations of the proponents of liberalisation and globalization, today many developing countries (*a fortiori* Latin American countries) can only achieve sustainable current account balances at much lower growth rates than before. Thus far from removing the external constraint, liberali-

[24] As Albert Berry (1997: 305) noted --before the current crisis began— "it is urgent to achieve better combinations of growth and distribution than those of the last two decades." Indeed, the World Bank (de Ferranti, et al, 2003: 2-9) notes inequality has generally risen in the region, with some notable exceptions (i.e., Brazil): see Figure 2.3 on page 2-10.

[25] As noted in Vos et al (2004), trade proved to be a weak motor for economic growth in the 1990s, due to its insufficient dynamism, increased vulnerability to international price fluctuations and poor export performance. Some countries, such as Mexico, Chile and Costa Rica did better than the rest, but even there the export –growth link was fairly tenuous.

sation has paradoxically strengthened it. UNCTAD economists (1999) ascribe this phenomenon to the much greater increase in the propensity to import than in the corresponding propensity to export for developing countries following trade liberalisation. These countries are consequently much more dependent on the external capital inflows to achieve the desired rates of growth which are compatible with strong employment creation and poverty reduction. Yet for most countries, under a regime of unregulated capital flows, the required inflows are either not available or subject to wide fluctuations (Singh, 2000:29). As a recent UNCTAD (2003c) report succinctly puts it,

> "The new policy orientation [in Latin America] created new dilemmas without resolving the old ones; in particular, the region remained unable to fully exploit its export potential and therefore continued to depend on foreign capital inflows. This led to the reappearance of balance-of-payments and debt problems similar to those that had contributed to the debt crisis in the first place"[26]

In this context, for policy makers in Latin America one of the most exasperating aspects of the switch towards a liberal trade regime has been the lack of a strong link between export growth, on the one hand, and a rapid expansion in output, productivity and employment on the other. This is true even in countries which have managed an impressive expansion of exports, such as Chile and Mexico. For Latin America as a whole, export growth (in value terms) reached 10 per cent a year in the 1990s, a significant improvement over the 4 per cent of the 1980s (Bouzas and Keifman, 2003: Table 7.2).[27] Nonetheless, apparently export growth has not exercised much impact on the overall growth performance (in terms of income per capita), and had only a weak influence on poverty reduction.

The collapse of the export multiplier has been puzzling for researchers. In the case of Mexico, Mold and Rozo (2004) ascribe the phenomenon to the gradual "hollowing out" of domestic industry, provoked by the spreading of *maquila*-type practices to the rest of the economy (i.e. a heavy dependence on imported intermediate products, and little or no local value-added). This change in the modus operandi of national firms has been provoked by, among other things, the way in which liberalisation was implemented, with a strong emphasis on *maquila*-type activities, and, until 1994, a chronically overvalued national currency (Lustig, 2001).

Recent research by Gaunza, Morely, Robinson (2004), on the other hand, generally exonerates the process of trade liberalisation for the poor economic results of the region. By use of general equilibrium modelling techniques for 16 countries in the region, the authors simulate the extent to which trade reforms have been responsible for the slowdown of economic growth, rising inequality and rising poverty observed in many parts of Latin America. They conclude that, generally speaking, the aggregate effects of trade liberalization and further multilateral trade integration tend to be mildly positive in terms of growth and employment creation. There is more mixed evidence for the poverty effects, but isolating the trade reform effects, these tend to be rather small in the aggregate.[28]

To the extent that increases in poverty have generally coincided with the economic crises which have struck the region, the conclusion of Gaunza et al seems plausible. Macroeconomic mismanagement, rather than trade

[26] The underlying problem is, as Sanchez (2003:1991) stresses, the low level of domestic savings: "Many longstanding observers of the region consider the low level of domestic savings to be one of the most serious obstacles to the macroeconomic situation in Latin America. Indeed, a good number would predictably rank it as the most important structural macroeconomic deficiency. Many other ills stem from it, in what is an unmistakable chain-link of causation: dependence on foreign savings renders policy subservient to the requirements of outside investors, which leads to pro-cyclical economic policies, sky-high macroeconomic volatility, and closing the vicious circle, reduced private domestic savings and long-term investments."

[27] If we exclude Mexico from the figures, however, the data is somewhat less impressive, with only a 7 per cent growth rate of exports in value terms.

[28] Nonetheless, the methodology used by Ganuza et al. (2004) is fairly controversial, especially for deducing real economy effects. The modelling simulations are basically dependent upon not only the quality of the input-output data sets, but also key assumptions regarding elasticities, returns to scale, competition, etc. As a result, they have proved to be less than satisfactory for predicting outcomes. For critiques of these models, see Dunkley (2004) or Panagariya (2002).

liberalisation per se, would be one of the prime culprits for the deterioration or stagnation in living standards. Massive devaluations caused inflationary surges because indispensable imports now cost much more in the local currency. Central banks raised interest rates in efforts to stabilize the exchange rate and fight inflation, slowing down economic growth in the process. Unemployment rose and government revenues fell, leading to expenditure cuts (since budgets were not allowed to go very far out of balance even in a recession) that reinforced market dynamics. These dynamics results in economic growth at half the pace registered under ISI (Stallings and Perez, 2000:90). Nonetheless, to the extent that trade liberalisation was part and parcel of the package of policy reforms thrust on the continent in the aftermath of the debt crisis, it is perhaps difficult to extricate trade policy from blame (as Gaunza et al (2004) do).

Latin America has traditionally been well-known for its pessimistic views on export-led growth. Although most orthodox economists would deny it, that pessimism is fairly well founded. The terms of trade have generally been highly unfavourable to Latin American countries. Although recently there has been an up-turn in commodity prices, the non-oil exporting countries of Latin America suffered a deterioration in their terms of trade of -14.9% over the period 1998-2002, with the hardest hit of all being Peru (-22.7%) and Chile (-17.5%). Despite the fact that the region has a longer history of industrialisation than sub-Saharan Africa or South Asia, many Latin American countries still have a pronounced dependence on primary commodities. Primary commodities account for more than half of all exports from Latin America (51%), surpassed only by sub-Saharan Africa (57%). The degree of dependence on primary commodities is especially high for the poorest Latin American countries, such as Paraguay (80%), Bolivia (71%) or Nicaragua (92%). Even Chile, often portrayed as a model of export-led growth for other countries in the region to follow, still depends heavily on primary exports (81%)[29]. Over the long term, a structurally-excessive dependence on primary commodities and the corresponding shifts in the terms of trade more than wipe out any advantages from preferential tariff regimes.

That said it should be recognised that Mexico and some of the Caribbean countries have achieved a notable degree of diversification in recent years. Mexico in particular has achieved a remarkably dramatic diversification, from a situation wherein oil accounted to approximately 80 percent of export earnings in 1982, to the inverse situation now, when manufacturing products contribute 84 percent of total export earnings. In general, the experience of Mexico and the Central American countries differs from the rest of Latin America in the sense that they have benefited from privileged access to the US market – in the case of Mexico, through the North American Free Trade Agreement (NAFTA), operational since 1994, and in the case of the Caribbean countries, through the Caribbean Basin Initiative (CBI), in force since 1983[30].

Nonetheless, although these agreements have been successful in promoting trade per se, they have not been so successful in providing a catalyst to broad based economic growth. The situation in Mexico has been particularly striking – in the space of fifteen years, Mexico has managed to convert itself into one of the ten leading exporters <u>in the world</u>, with exports o 164 billion US$ in 2002. This is ahead even of that much cited example of export promotion, South Korea. This is an astounding success for a country that, in the 1980s, had widely become regarded as the basket-case economy of Latin America. Yet income growth has been extremely sluggish during this period and, according to the Commission set up by President Fox to evaluate the levels of poverty, "the absolute number of people below the poverty line increased from 19.1 million to 23.8 million between 1992 and

[29] Although Chile has also shown that this is not, at least until now, incompatible with being increasingly competitive internationally.

[30] NAFTA is, of course, not a preferential agreement but a regional free trade one. Generally speaking, even when granting preferential (i.e. non-reciprocal) access, the United States usually conditions inclusion into its scheme upon adherence to a set of demands, such as capital account liberalisation, privatization, etc. Thus, for instance, the African Growth and Opportunity Act requires signatory countries to 'make progress towards market-based economies, strengthening the rule of law, eliminating barriers to US trade and investment, protecting intellectual property, combating corruption, protecting human rights, and eliminating certain child labour practices (Cline, 2003:91). In this sense, United States preferential agreements are not developmental in the way that EU ones are – they come with considerable strings attached.

2000, an increase of 4.7 million persons" (Cortés et al, 2002:15).

In sum, Latin American development has been fraught with obstacles, some domestic and others external. This region has certain advantages with regards to other developing areas, but it is far from being able to resolve its problems autonomously. The United States is Latin America's main, natural partner, but the region needs to diversify its foreign ties in order to avoid excessive dependence. In this area, the European Union is key. The question is: will the EU respond accordingly? The next chapter examines this issue.

1.5. LATIN AMERICAN TIES WITH THE EUROPEAN UNION

When analysing the GSP, it is necessary to review overall bi-regional trade relations. Reflecting the depth of the Latin American debt crisis, EU-Latin American commerce increased only slightly during the 1980s, rising from 32 billion euros in 1980 to 43 billion in 1990. The 1990s, on the contrary, were quite dynamic as trade between these two regions exceeded 100 billion euros in 2001, rising again to 111 billion euros in 2002.

Table 3
European Union Trade with Latin America/LA (Billions of ecu/euro and %)

	1980	1990	2001	2003
Imports from LA	17.8	27.0	52.0	50.0
Share of EU Total Imports (%)	6.5	6.2	5.6	5.7
Exports to LA	14.2	16.9	58.0	44.0
Share of EU Total Exports (%)	7.0	4.3	6.7	5.2
TRADE BALANCE	-3.6	-10.1	6.1	-6.0

SOURCE: European Commission, DG Trade.

However, this positive evolution in absolute terms masked a negative situation when this trade is compared with broader tendencies. One disturbing trend is that --in relative terms— Latin America has steadily become less and less important as a trading partner for the European Union. As a supplier to the EU, Latin America fell from 6.2% to 5.6% between 1990 and 200, improving only slightly since then (See Table 3). As a market for EU exports, this region has also declined in relevance from 1980 when it reached 7.0% until 2001 when it represented 6.7% (falling once again in 2003, to 5.2%). From Latin America's perspective, the EU has also fallen in importance as a destination for exports, from close to 30% in 1990 to only 13% in 2001, although it continues to be its second largest partner.[31]

In other words, while Latin exports to the world quadrupled in the 1990s, sales to the EU only managed to double in volume. This situation reflects a series of factors. Firstly, there is a clear trend towards the growing regionalization of trade within the Americas (a characteristic of intra-EU trade patterns for some decades). This has been one of the results of a network of bilateral and sub-regional free trade agreements signed over the past decade and a half. Secondly, Latin America's export offer to the EU –one quarter of which is in agricultural products— is concentrated in sectors whose prices have been falling in international markets. Related to this last point is a third factor: the limited success of efforts by Latin American countries to diversify into higher added-value and/or niche products. To be fair, though, --this would be the fourth factor— international competition is increasingly intense in numerous products where this region had or could have a certain comparative advantage.

[31] These trends are confirmed in a recent study by the Inter-American Development Bank (IADB, 2004), which includes more recent data and in-depth analysis. This report points out that this is mostly true even if Mexico is excluded from analysis (p. 7).

Three examples serve to illustrate this difficulty. One is coffee, the world price for which has fallen dramatically as a result of new entries in this export market (such as Vietnam), provoking heavy losses (and social instability) in several Latin American countries where this was traditionally an important source of hard currency and where whole areas are organised around the coffee economy. Diversifying requires a fundamental cultural change in these zones. Another example is cut flowers, a niche which Colombia managed to develop and lead –in competition with the Netherlands and Israel— but recently its share has fallen because of new competitors. Finally, several studies have noted that new illegal coca and poppy plantations in the Andes are replacing traditional and new crops in some zones. In fact, there is evidence that drug production has risen despite various repressive policies and incentives such as those provided by the GSP drugs scheme[32].

How did Latin American exports to the EU fare in relation to other developing regions? Table 4 shows that Latin America increased its exports by 180% since 1980. This placed the region in an intermediate position, between the dynamic exporters of Asia and the Mediterranean and the non-competitive countries in the Africa, Caribbean and Pacific (ACP) group (excluding South Africa which showed a performance similar to Latin America). As a group, the Least Developed Countries performed worse than Latin America. Within this zone, the Andes subregion demonstrated rates of growth only slightly above those of the ACP, while Central America was one of the most dynamic sub-regions, although in absolute terms its exports are relatively insignificant.

What is surprising to note is that the trend of declining EU-Latin American trade has taken place during a period when the EU has been relatively active in promoting closer economic ties with the region. This has been evident at several levels:

• The signing of Association agreements, including free trade, with Mexico and Chile, and the ongoing negotiations with the Mercosur countries which are set to conclude in October 2004;

• An increase in the amount and variety of instruments for economic co-operation[33], including AL-INVEST, Eurocentres, and support for regional integration schemes, etc;

• A growing amount of EU foreign direct investments in Latin America, reaching 39 billion euros in 2000. Overall FDI stock from the EU member states in this region represented some 11.3% of the total invested abroad;

• An increasing concentration of bi-regional policy fora (i.e., EU-Rio Group ministerial meetings) on economic issues; and

• The introduction of a more generous trade preference regime first for the Andean countries and later extended to Central America, with the express purpose of encouraging legal exports to the EU in order to reduce incentives for illicit drug trafficking.

However, this relatively positive policy framework has not contributed to improving the level of Latin American access to EU markets overall, and particularly in the case of the poorer countries.

Indeed, with regards to EU trade policy initiatives in Latin America, a clear tendency has emerged favouring richer partners. While free trade agreements have been signed with Mexico and Chile, and negotiations are in progress with the Mercosur countries, the rest of the region –the poorer countries— have been put "on hold" supposedly because they are "not ready" for a full trade partnership with the EU (although, surprisingly, Syria –a dictatorship with no history of regional integration— is considered "ready"). In any case, for the Andean and Central American countries, the GSP is all that is available until the two conditions established at the Guadalajara Summit are satisfied[34].

[32] See, for instance, study by TNI (2002).

[33] According to European Commission data, over 220 million euro will have been spent on "trade-related assistance" to Latin America between 1997 and 2006.

[34] Those conditions are: (1) that regional integration in both cases demonstrates clear advances, particularly in terms of consolidating common markets, and (2) that negotiations will depend on what happens with the WTO Doha Round.

Table 4
EU Imports from Selected Developing Regions (billions of ecu/euros)

Regions/Countries	1980	1990	2001*	2003	Change (1980- 2001/03)
ACP (including S. Africa)	28,6	27,9	47,5		66,1%
South Africa	6,9	7,5	15,6		126,1%
ASEM**	27,0	89,0		245,0	807,4%
China			81,6	105,0	
Latin America	17,8	27,1	52,0	50,0	180,9%
Andean Community	5,0	4,8	8,5		70,0%
Central America	1,1	1,7	3,4		209,1%
Mercosur			25,8	25,8	
Mediterranean***	14,7	27,7	66,8		354,4%
Least Developed Countries	6,1	7,1	14,3		134,4%

SOURCE: Prepared by authors from: European Commission DG Trade data base (http://europa.eu.int/comm/trade/issues/bilateral/data.htm).
*Year for Andean Community, Mediterranean countries, South Africa and LDCs is 2002.
** ASEM: Brunei, Indonesia, Malaysia, Philippines, Singapore, Thailand, Vietnam, China, Japan and South Korea.
*** Morocco, Algeria, Tunisia, Israel, Egypt, Jordan, Lebanon, Syria, Gaza and Jericho, Cyprus, Malta and Turkey.

These are also the countries where EU development assistance for Latin America has been concentrated. However, it should be noted that co-operation flows from the EU stagnated in the 1990s. Indeed, while the annual average of aid from the Community and the 15 member states in 1992-1996 reached 2.26 billion dollars, in the following five-year period, it fell to just above 1.8 billion dollars; roughly two thirds of this was distributed among the Andean and Central American nations.

Fortunately, there has been a greater focus in EU aid on reducing poverty and promoting social cohesion. These concerns are fairly well-integrated into the country, sub-regional and regional strategy papers. In this line, the Commission placed social cohesion at the forefront of the agenda for the bi-regional summit in Guadalajara, Mexico.

Against this backdrop, EU-Latin American trading relations have been permeated with tensions over the last twenty years or so. Many Latin American countries have felt prejudiced by the EU's more favourable treatment of lower income developing countries in its trade policies. The Common Agricultural Policy (CAP) has been a major bone of contention. As a net agricultural exporting region, Latin America has a vested interest in seeing the reduction or elimination to restrictions for agricultural imports. One study by the World Bank (2001) concluded that the overall costs of the CAP in terms of lost market shares and lower prices were highest for Latin America, losing $4 billion annually from EU farm policies alone. The impacts were estimated to be particularly damaging for Argentina and Uruguay, for whom the EU's CAP depresses terms of trade by 7 and 8 per cent respecttively. It is not coincidental that, of the new block of twenty-one developing countries (the so-called G-21) that emerged just before the WTO ministerial meeting in September 2003 in Cancun, Mexico, no less than 12 of them were Latin American.

Finally, it is important to underline the fact that Latin America's trade relations with the EU are closely interlinked with its commercial ties with the US. Thus, Washington's policy initiatives in Latin America are followed closely in Brussels and other European capitals. Although the EU acknowledges its inherent disadvantage *vis-à-vis* the US (i.e, with regards to distance), the EU makes every effort to avoid losing its "market share" in Latin America. For this region, this competition is useful in diversifying its external trade. With respect to trade preferences, both the US and the EU provided similar schemes until recently, including special regimes for drug-producing countries in Latin America. However, lately, the United States seems to be taking a more decisive approach in winding down in unilateral preferential systems for the region, as it favour free trade agreements; these were recently signed with Chile and Central American countries and negotiations are in progress with some Andean countries. This changing panorama in Latin America will make it increasingly hard for the EU to continue to base its trade relations with close to a dozen countries on preferences whose benefits are steadily eroding (and will probably continue to do so with the proposed regime for after 2005).

2. The EU's GSP and Poverty in Latin America

2.1. OVERVIEW OF EU TRADE POLICY TOWARDS DEVELOPING COUNTRIES

The European Union is the largest trading block in the world and the largest trader with developing countries. As such, it is a key actor in determining the extent to which poorer countries are integrated in the world economy.

However, EU external trade policies are not primarily shaped by these facts. Instead they are mostly determined or constrained by internal goals of the Community. In its early years, there were no special considerations for developing countries, but over time a fragmented policy framework emerged. The main division in that structure was between associated partners –mainly the countries of Africa, the Caribbean and the Pacific (ACP), and later the Mediterranean countries— and non-associated countries (Asia and Latin America).

An important factor to bear in mind and which explains why EU policy has been fundamentally driven by internal interests is that trade with developing countries was never "critical [ ] to the macroeconomic well-being of the Community, nor to its security" (Grilli, 1993: 140). In fact, apart from oil imports, the relevance of trade with developing countries has tended to diminish over the past decades. When a particular sector of the EU was deemed at risk, the policy orientation of the Union was to implement defensive measures (i.e., the CAP).

For those countries that did not pose a threat and for which there were strong political interests, the policy of the EU was to provide compensatory trade concessions. These were first provided to the associates, mostly former colonies in Africa (later expanded to the Caribbean and the Pacific) through the successive Yaoundé and Lomé conventions. These agreements provided duty-free access to most products on a contractual basis, in addition to measures to compensate for price fluctuations in certain sectors. These countries were at the top of the "pyramid of privilege", the Mediterranean countries were in the middle and the Latin American and Asian countries were at the bottom. EU policy for these last two regions was to provide a "one-size-fits-all", unilaterally-designed, market access regime, the Generalised System of Preferences, created in 1971. Since then, the GSP has gone through a series of reforms. Perhaps the most relevant changes took place in the 1990s, with the introduction of the special scheme for countries affected by illegal narcotics trafficking and production, the social and environmental incentives and the EBA regime for the poorest countries. The consolidation of disparate frameworks in a single regulation in 2001, including the controversial "graduation clause", was one of the latest major changes.

In sum, trade treatment by the Community for developing countries was highly differentiated by regions. This functioned reasonably well (from the EU perspective), but it created a series of conflicts between or even within regions as governments complained to Brussels that other countries or groups received better treatment.

In the 1990s a process of relative convergence in EU trade policy for developing countries began to take shape. This was a result of several factors. One was that the web of instruments was increasingly complex to manage. Secondly, as a result of the completion of the GATT Uruguay Round in 1994, many aspects of this policy needed to be adapted to a new global trade context. In relation to this, there was clear erosion in the value of the various preferential regimes on offer. Thirdly, in a context of increased global competition, interest in North-South free trade agreements rose, particularly after the North American Free Trade Agreement (NAFTA) became operative in January 1994.

Finally, the overall review of the Community's development policy needed to be integrated with the emerging trade policy in order to maintain a minimum level of coherence, a demand included in the Treaty of the European Union (TEU) itself. For this purpose, the Commission's communication on development policy (CEC, 2000) underlined the need to use the three policy instruments at its disposal –trade, aid and dialogue— such that they mutually reinforce each other, always with the ultimate goal of reducing poverty. As one of six priority areas, trade policy received considerable attention in this document. In this context, the EU called for a more just and fair multilateral trading system and, in its bilateral ties with developing countries, it promised to introduce measures to improve market access and increase efforts to promote regional integration.

Nevertheless, this document's orientation was focussed on development cooperation rather than on other policy tools. The link between trade and development was more explicitly addressed in another communication in September 2002 (CEC, 2002). Its objective was to "spell out the way the EU can fulfil its global commitments in support of the efforts of developing countries to better reap the benefits of trade and investment". The main premise of that Commission document is that "trade can foster growth and poverty reduction and be an important catalyst for sustainable development". This is only possible, as it correctly argues, when trade is "part of a wider, country-owned strategy". It also noted the need to integrate three types of strategies in order to ensure trade contributes more to growth and development: (1) sound macroeconomic policies, effective economic and social governance, human capital development and regional integration; (2) better market access and balanced trade rules; and (3) trade-related assistance and capacity building to help developing countries with these tasks. In sum, the solution to development challenges involves a combination of efforts by developing countries and the EU, bilaterally and through the multilateral system.

In the area of market access, the Commission recognized that preferences "have not always been used to the full", so it promised to work to achieve "more comprehensive use" of the GSP. These general principles were accompanied by analysis of the link between trade and development as well as a series of concrete proposals for action with regards to policy dialogue and enhancing effectiveness of EU and multilateral support.

With regards to this last area, the inter DG Task Force for Trade and Development was set up to improve coherence and assist in mainstreaming trade issues in the Country and Regional Strategy Papers (CSPs/RSPs). In May 2003, based on a broad consultation between the various departments involved, it presented a pioneering text providing guidelines for trade-related assistance/TRA (CEC, 2003c) --including both support for long term capacity building and short term technical assistance--. Several new programmes have been initiated in this area, with a particular focus on the ACP group, although there are some actions in Latin America[35].

All of these initiatives were to be taken forward through multilateral and bilateral actions. On the global level, the EU was one of the main promoters of a new round in the WTO focused on development concerns, which was materialized in the Doha Development Agenda in November 2001. In addition to concerns about strengthening the multilateral trade regime, this interest came in response to the complaints by many poorer countries that the rich nations had not kept their side of the bargain in the earlier round, resulting in insufficient access to their markets, particularly for agricultural goods.

However, the failure of the WTO ministerial conference in Cancun in September 2003 reflected a series of unresolved tensions between rich and poor countries as well as this multilateral organisation's structural limitations. As a result, the UE decided to

[35] One example is a 5 million euro programme in Bolivia which intends to improve trade and investment flows with the EU through a variety of actions. The overall objective cites the reduction of poverty as one goal. Among the factors in the context cited to justify this initiative is that Bolivia has not been able to increase its exports to the EU despite benefiting from the GSP drugs scheme. This programme was evaluated in early 2004 (ADE, 2004).

re-evaluate its strategy. In November 2003 it produced a new communication aimed at reviving multilateral negotiations (CEC, 2003b). A meeting between the Trade Commissioner and representatives of the G20 group of developing countries in Brazil lead to a joint communiqué in favour of restarting talks in early 2004.

Among the lessons which the European Commission found in the Cancun experience is that "preferential access for the weakest of the developing countries [..] can be vital for their integration in world markets" (CEC, 2003b: 7). But, at the same time it launched an implicit criticism (several times) of "special and differential treatment" which it sees as ineffective. Nevertheless, the EU also suggests that the middle-income developing countries might consider providing preferences to the least advanced nations. These ideas point to and reflect a shift in the orientation of the EU preferential regime –mentioned in the October 2003 press release on this topic— to aim benefits mostly at the poorest countries.

This new focus also meshed well with the WTO decision on the GSP, formally adopted by the Dispute Settlement Body on April 20, 2004. This body found that the EU "could differentiate among beneficiaries provided such preferences are based on objective and transparent criteria and are made available to all similarly-situated developing countries" (Apea, 2004:4). The decision also obliged the EU to bring the special drug arrangements into conformity with its WTO obligations. Since there was no agreement between the parties on when the EU should comply with this, an arbitrator was chosen and he gave the Commission until July 1, 2005 (WTO, 2004: 27).

As a result, the Commission began an internal reflection on reforming the GSP as a whole, which lead to a Communication in July 2004 (CE 2004e), establishing guidelines for that process which would end with a new regulation which should enter into force on January 1, 2006. This Communication developed the following main ideas:

- The GSP is one of the key instruments to assist developing countries in reducing poverty;
- This preferential system is part of a wide set of trade policy priorities, including the "Doha Agenda", aimed at developing countries;
- The regime must be "stable, predictable, objective and simple", building on past experience and reducing the number of arrangements;
- Preferences must be targeted on the countries that most need it and should encourage regional cooperation;
- The goal of promoting sustainable development must be more prominent through a single set of additional concessions based on acceptance and implementation of international conventions relating to social rights, environmental protection and governance, including the fight against drugs.

The July 2004 guidelines recognized that efforts to promote development and eradicate poverty needed to be stepped up and that part of the solution required enhancing "the effectiveness of external trade policy instruments, such as the GSP" (EC, 2004e: 4). In this line, the Commission's own review found that GSP imports had not risen as fast as overall imports in the 1990s.

On October 20, 2004, based on these guidelines, the Commission adopted a formal policy proposal setting out the details of the new EU GSP for the period 2006-2008 (EC, 2004f). This proposal introduces several important changes. First, it reduces the present five schemes to three: the general scheme, set to incorporate 300 additional products; the EBA; and a new "special GSP+" for "vulnerable countries with special development needs". To benefit from this last scheme –this is a sort of "add-on" to the first two schemes— countries must meet a number of criteria, including the ratification and effective application of 27 international conventions. These countries must also demonstrate they are "small beneficiaries" (that GSP-covered imports represent less than 1% of total EU GSP imports) and that their economies are "poorly diversifies" (five largest sectors of GSP-covered imports represent more than 75% of its total GSP imports).

A second set of innovations related to the mechanism for graduation which is "simplified". A single criterion (share of Community market expressed as a share of preferential imports –up to 50%-- for a given group of products) will be applied instead of the present complex mechanism. Finally, the Commission will introduce changes to make the rules of origin more flexible, in particular with the aim of enhancing regionnal accumulation (that a given proportion of the origin of a product can be regional and not just national in order to take advantage of GSP benefits).

While this policy change is generally positive it ignores an intense controversy that has recently taken place amongst development economists as to the benefits/costs of a policy of trade preferences. Most liberal economists oppose preferences granted to poorer developing countries, on the grounds that it undermines the system of multilateral liberalisation. The World Bank, for instance, has argued that "nonreciprocal preferences like GSP are a "Faustian bargain". The basic criticism is that the GSP is anti-trade and that, on balance, the system actually delays a poor country's efforts to liberalise. Trade diversion effects may be larger than the benefits from trade creation between the two bilateral partners involved in the preferential agreement, especially if the rules of origin are excessively strict. It may also engender deterioration in the quality of the trade between two countries, artificially shifting economic activity towards sectors where trade preferences exist, but out of line with the country's long-term comparative advantage. In addition, once benefits are lifted, or eroded by tariff reduction with competing countries, the costs of adjustment are inevitably high.[36]

Using a gravity model econometric specification, Rose (2002) reaches the conclusion that the GSP approximately doubled the volume of trade between signing partners This is of course exactly the opposite view to which orthodox economists would usually subscribe, and suggests that, far from being damaging, bilateral mechanisms of trade concessions might actually contribute to export growth and, by implication, poverty reduction.

In short, although Rose's heterodox findings concerning the impact of the GSP on trade volumes are suggestive, they are inconclusive. With the interaction of so many different factors and the difficulty of capturing the essence of an overall trade regime in a few variables, it is perhaps doubtful that any single cross-sectional time series study resolves the issue definitively. Bearing this in mind, this study limits its scope to more detailed, country-level, data, focusing particularly on low-income countries of Latin America. In addition, because of the possibility of a disjuncture between trade growth and poverty reduction, we explore some of the plausible links between these two variables.

This new scheme seems to be more in line with a poverty reduction focus, but it may create problems for middle income countries (MICs) where a significant proportion of the population are also living in poverty. This is particularly worrisome since there has already been a clear trend in foreign aid distribution away from this group of nations (basing cut-offs primarily on the GDP per capita indicator).

Moreover, this policy trend may have significant strategic costs. The possible "graduation" of Latin American countries that are not offered the alternative of a free trade agreement with the European Union will enhance the current tendency in that region –not out of choice but because it is seen as the only option— to strengthen commercial links with the United States, reducing even further the EU's economic presence in the region.

2.2. THE EUROPEAN UNION'S GSP AND LATIN AMERICA

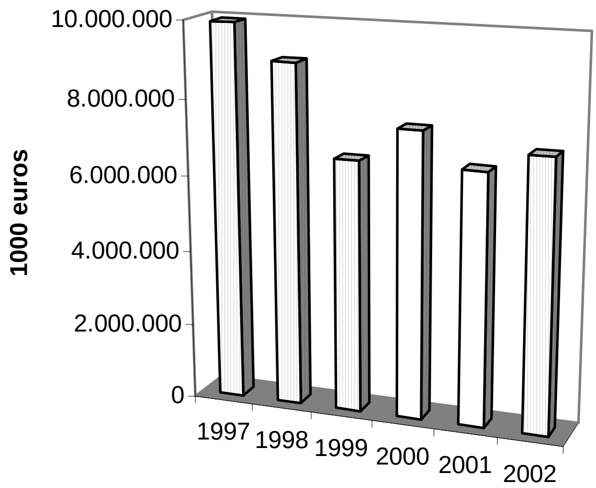
From a developmental standpoint, Latin American countries have received preferential access to the European market within the framework of the GSP since 1971. The coverage rate of the EU GSP is very comprehensive: over 99 per cent of imports from developing countries of products that

[36] Bangladesh is commonly cited as an example of this. The EU provides preferential market access for Bangladesh's garment exports, exempting them from its 12.5 percent import tariff. At the beginning of the 1980s, garment exports were practically negligible. In the intervening twenty years, the industry has grown to contribute approximately $4 billion a year to the balance of payments. However, with the imminent phasing out of the Multi-Fibre Arrangement (MFA) in 2005, Bangladesh's garment industry will face full-fledged competition from other low-cost producers like China, India or Turkey.

are subject to duties in the EU are eligible for preferences. Within the framework of the GSP, the EU has granted the Andean countries special preferential access conditions (exemption or reduction of tariffs) since December 13, 1990. These additional clauses were added for Andean countries committed to tackling drug production and trafficking. The scheme remained unchanged until December 31, 1994 when the EU presented a new "Multi-annual Scheme of Generalised Tariff Preferences" (GSP) to the Andean Countries for a ten-year period, 1995-2004 (CEC, 2003c). The scheme was also extended to Venezuela and the Central American countries and, as of 2002, to Pakistan.

A rigorous examination of trade effects should focus on products where the margin of preference (exemption from tariff and non-tariff barriers) is large (e.g. fisheries, clothing and fruit and clothing), and on countries that have not strongly discriminated against exports. It should also be remembered that the trade stimulating effect of preferences is provided by the effective tariff rate (including the tariff equivalent of non-tariff barriers from which the beneficiary is exempt), and not just by the nominal rate (McQueen, 1998:427).

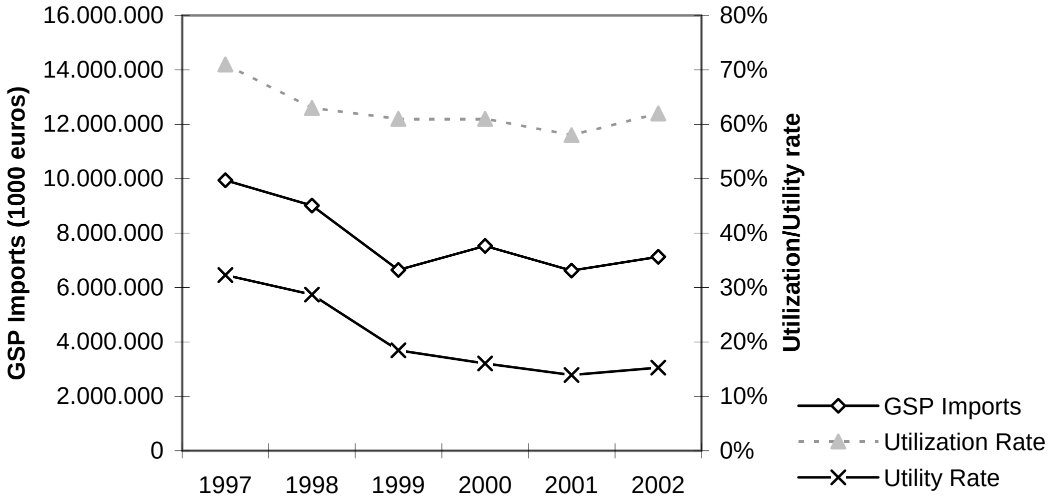
Graph 1
EU imports from Latin America using GSP preferences, 1997-2002



SOURCE: Prepared by authors on the basis of data provided by DG Trade, European Commission.

However, the data available does show a noticeable concentration (69% in 1997-2002) of Latin America's exports to the EU in the four largest economies (Argentina, Brazil, Chile and Mexico), which have also benefited from the GSP. The Andean and Central American nations seem to have utilised these preferences fairly effectively (an annual average of 76% and 69% respectively in the period 1997-2002), but so have the richer countries in the region. In fact, Argentina, Brazil and Chile alone accounted for about half of the EU GSP imports from Latin America in 2001-2002 (up from 40% in 1999-2000). However, the region as a whole has seen its GSP benefits fall over the past decade (see Graph 1) both in absolute (a fall from almost 10 billion euros in 1997 to 7 billion in 2002) and relative terms (declines in the utilisation rate from 71% to 62% and the utility rate —GSP imports/total imports— from 32% to 15%), as can be seen in Graph 2.

Graph 2. Latin America-EU GSP imports, 1997-2002



SOURCE: Prepared by authors on the basis of data provided by DG Trade, European Commission.

From its inception, the EU's GSP scheme received criticisms from Latin American countries on a number of grounds:

- It was argued that the GSP offered few real additional benefits to trading partners, due to the exclusion of most agriculture products;
- It was criticised for not offering sufficient tariff reductions for certain manufacturing goods (particularly labour intensive goods like textiles):
- It does not resolve the problems associated with non-tariff barriers (NTBs);
- The GSP has apparently done little to encourage structural diversifycation;
- Finally, there have been many complaints regarding the lack of transparency in the application of GSP rules (Sanahuja, 2000:6).

In addition, for many Latin American countries, the GSP represents an unfavourable treatment vis-à-vis the EU's Association Agreements with the Mediterranean countries, or the signatories of the Lomé and Cotonou Agreements. Certainly, analyses of how trade patterns have subsequently evolved in Latin America since the granting of preferences hardly revindicate the role of the GSP. With regard to the GSP-drug regime, an in-depth study by Nieto (2002) of the trading relations between the Andean countries (Bolivia, Colombia, Ecuador, Peru and Venezuela) and the EU reveals that, whereas exports of products to the rest of the world included under the Andean GSP+ agreement grew by 30% between 1998 and 2000, exports from the Andean countries to the EU grew by only 8.7% over the same period.

This kind of information is in fact commonplace in the literature on the effectiveness of EU trading preferences. It is often, for example, taken as a damming indictment of EU trading preferences that, despite enjoying very significant preferences, the exports of the ACP countries to the EU market has fallen from 6.7% of world exports in 1975 to 2.7% in 1995 (Buster, 2002: 104). Caution needs to be exercised in interpreting this data, however. To some extent, it would be misleading to compare the GSP-drugs country exports with the much better performance of developing countries as a group, in part because a major part of the increment in non-oil exports from developing countries is due to the success in promoting manufacturing exports from a small handful of countries (principally, China, South Korea, Mexico, Taiwan, Hong Kong, Malaysia and Indonesia). An examination of trade effects should therefore focus on products where the margin of preference (exemption from tariff and non-tariff barriers) is large (e.g.

fisheries, clothing and fruit and clothing), and on countries that have not strongly discriminated against exports. It should also be remembered that the trade stimulating effect of preferences is provided by the effective tariff rate (including the tariff equivalent o non-tariff barriers from which the beneficiary is exempt), and not just by the nominal rate (McQueen, 1998:427).

Table 5

GSP for Latin American and Caribbean Countries, 2002 (millions of euro %)

	Total Imports	Eligible Imports	Preferential Imports	Utilisation rate	Utility Rate
Argentina	1862	1698	1333	79	72
Bahamas	67	67	1	1	1
Belize	7	7	-	0	0
Bolivia	11	11	9	81	81
Brazil	5282	3392	2530	75	48
Costa Rica	440	439	385	88	88
Cuba	206	205	185	90	90
Chile	858	514	432	84	50
Dominican Republic	148	148	4	3	3
Ecuador	318	317	269	85	85
El Salvador	19	19	8	39	39
Guatemala	119	119	94	79	79
Guyana	10	10	-	0	0
Haiti	4	4	2	48	48
Honduras	93	92	77	84	83
Jamaica	96	96	2	2	2
Mexico	2670	2599	105	4	4
Nicaragua	27	27	23	85	85
Panama	42	42	27	64	64
Paraguay	21	21	13	62	62
Peru	405	404	377	93	93
Suriname	26	25	2	8	8
Trinidad and Tobago	402	379	25	7	6
Uruguay	143	134	97	72	68
Total (Latin America)	**13351**	**10843**	**5999**	**55**	**44**
Total (World)	**155845**	**99099**	**52822**	**53**	**34**

SOURCE: Calculated from data provided by DG-Trade. The data excludes some small island economies.

Regrettably, the required data for such an in-depth analysis was not available at the time of the writing up of the current study[37]. However, Table 5 reveals the calculations of utilization and utility rates for Latin America based on the most recent data available by the Commission (2002).[38] In fact, the average utilisation rates for the region, at 55 percent, stands at a very similar level as the average levels for all GSP beneficiaries. The utility rate is somewhat higher, reflecting perhaps a slightly more adequate targeting

[37] This is a problem faced by other researchers. Indeed, Stevens and Kennan (2004) were not able to obtain appropriate data from the European Commission for a study they carried out on preferences for ACP countries, so the World Bank provided access to its data base.

[38] The utilisation rate is the ratio of imports that enter the EU market under the GSP compared to total eligible imports from the country in question. The utility rate, on the other hand, is the ratio of preferential imports compared to total imports.

of products by the EU in the granting of preferences to the region. However, what is particularly striking is the degree of variability regarding the up-take of the preferences on offer, with countries like Peru (93 percent), Cuba (90 percent), Costa Rica (88 percent) and Chile (84 percent) showing exceptionally high utilisation rates, whereas some of the poorest countries in the region, like the Dominican Republic (3 percent), Haiti (48 percent) or El Salvador (39 per cent) show much lower levels of utilisation. To some extent, therefore, the Commission's own data contradicts the oft-made accusation that the Latin American countries do not make sufficient use of the existing preferences on offer. Some countries evidently do take good advantage of the system as it now stands.

The European Commission, for its part, blames the lack of success of the GSP system on the weak supply-side response on the part of the Latin American countries themselves. They claim that most Latin American countries have been unable even to support regional initiatives to increase trade among them, let alone enhance international competitiveness relative to the rest of the world. Regional integration within Latin America is therefore considered by the European Commission as a preliminary first step to enhancing export competitiveness. In this sense, their reaction has been to promote the "better use" of the GSP by supporting the diversification of the export structure through the financing of activities designed to promote trade and increase knowledge of the European market (e.g. trade fairs, market studies, measures to support quality control). Although these policies may be considered a step in the right direction, this kind of measure has not yet met with much success in altering the asymmetry of trading relations between the two regions.

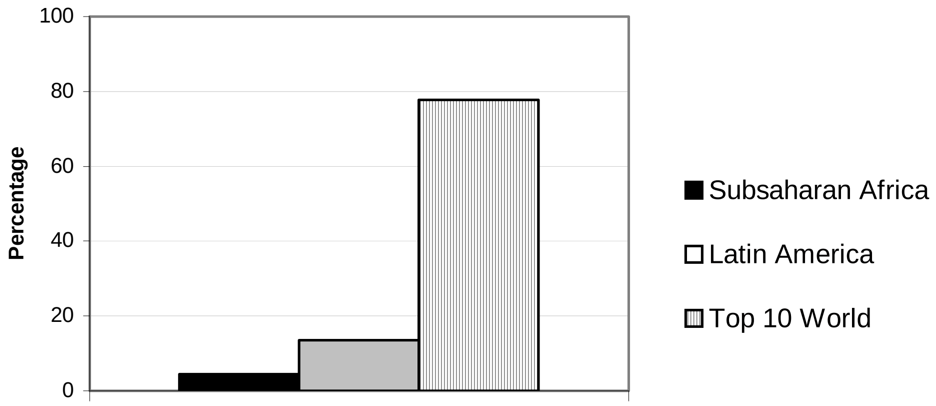
In comparative terms, Latin America enjoys a larger share of the GSP than Sub-Saharan Africa, as could be expected given the large difference in regional products. Nevertheless, the countries which have gained the most from the GSP are concentrated in Asia. Indeed, in 2001-2002, the GSP imports to the EU of three countries —China, India and Indonesia— represented over 50% of the world total. When this group is expanded to consider the "top 10" GSP beneficiaries in trade (in dollar terms) –only Brazil and South Africa are non-Asian economies– their share reaches close to four fifths of the total (see Graph 3).

In sum, the idea that Latin America has benefited considerably from the EU GSP is hard to sustain. Moreover, the empirical evidence does not show that the special GSP regime for Andean and Central American countries (GSP+/GSP-Drugs) has resulted in significantly better access for their goods to the EU market[39]. Between 1997 and 2002 the value of total exports to the EU rose by 51% while GSP exports fell by 28%. It is true that over 7 billion euros worth of products enjoyed zero tariffs, but it is also clear that the full potential has not been reached. Moreover, the data available tells us next to nothing about the impact on poverty of these GSP benefits.

A recent evaluation of Colombia's utilization of the EU GSP (Gonzalez, 2003) carried out by a private sector association –one of the few existing— concludes that the scheme overall has not contributed to increased Colombian exports. The agricultural sector was the most benefited, but operators in that area have used the preferential scheme more as a "market stabilization mechanism than as a promoter of exports". Industrial exports have fallen despite improved conditions in the GSP regulation. The most positive impact of the GSP has been on diversifying Colombia's export offer, but trade remains highly concentrated in few products. Despite its complete treatment of many aspects, this examination of the GSP barely deals with its socioeconomic impact. An exception to this is when it analyzes the possible graduation of the fishery sector, where it details the number of people employed and the fact that women heads of household would be the most affected.

[39] However, the Secretariat for Central American Economic Integration (SIECA), in a study on the level of utilization of the GSP drugs scheme by countries in that sub-region (2002), noted it was low. For instance, they noted that the number of products which benefited from this regime ranged from 7 to 13 out of close to 1000 products included in the GSP. In a detailed analysis of GSP usage in the Andean sub-region, a recent study (Nieto, 2002) concludes that the advantages of the GSP were not sufficient to stimulate trade between the EU and its Andean partners. In fact, these countries mostly exported non-dynamic products through the GSP.

Graph 3
Share of preferential imports in comparison (Average 2001-2002)



SOURCE: Prepared by authors on the basis of data provided by DG Trade, European Commission.
Note: Top 10 recipients of GSP benefits in the world includes Brazil.

What are the problems that have arisen?

One of the main problems for beneficiary countries is precisely the frequency with which the EU revises the rules for GSP (every three years). This means that the whole system is effectively put on a "short leash", increasing uncertainty about the permanence of the benefits on offer. Indeed, it is not clear that the new regulation will overcome this limitation because the July 2004 guidelines (EC, 2004e) refer to the 2006-2015 period, while the Commission's October 2004 proposal (EC, 2004f) is limited to the three-year period beginning on July 1, 2005.

A related problem is that the safeguard clause in the EU's Generalised System of Preferences is restrictive and gives the EU a wide discretion in its use (McQueen, 1998). It refers to "cause or threaten to cause serious difficulties to a Community producer of like or directly competing products" with the factors taken into consideration including "low rate of capacity utilisation, falling stocks or production, low profitability, declining market share of EU producers", with beneficiary countries being "informed" (i.e. not consulted) before the safeguard measures are put into effect.[40]

[40] Council Regulation (EC) Nº 3881/94, Article 14.

Even if in reality these measures are never put into practice, the mere existence of such safeguard clauses is often sufficient to dissuade investment in beneficiary sectors.

In addition, as Brenton and Manchin (2003:757) stress, "the striking feature of the EU scheme is the low utilisation of these preferences"[41]. Data for 1999 reveal that only one third of EU imports from developing countries which were eligible for preferences actually entered the EU market with reduced duties. Why is this so? Increasingly, the finger is being pointed to the excessively strict rules of origin as one of the principal stumbling blocks.[42] Rules of origin for small, undiversified developing countries are very damaging indeed, because they severely limit the extent to which they are able to take advantage of any preferential agreement – the weak domestic industry is usually highly dependent on imports for intermediate products, given the lack of sourcing possibilities within the country itself.[43] This

[41] A recent study by UNCTAD (2003) notes this is a common problem for all developing countries and for all preferential schemes.

[42] See, for instance, Brenton and Manchin (2003) and Mattoo, Roy and Subramaniam (2003).

[43] See Stevens and Kennan (2004a) for a discussion on Rules of Origin in the EU GSP. UNCTAD (2003) makes a strong criticism of these rules which is considers to be one of the

is especially true for countries like Paraguay and Bolivia where primary products represent approximately 80 percent of total exports, and local value-added is generally very low. In practice, countries in this situation would have a hard time meeting EU requirements regarding rules of origin.

In the mid-1990s, the particularly controversial instrument of "graduation" was introduced to the GSP, which implied that once certain sectors within a country reached a pre-determined level of exports or a pre-determined level of per capita income, it would be "graduated" from the GSP scheme, and MFN tariffs would thereafter be applied. Graduation has already been applied to a number of sectors in Latin American countries like Argentina and Brazil. The most recent countries to "suffer" graduation are Costa Rica and Colombia. The mechanism of graduation defeats the purpose of the GSP, because countries that manage to gain competitiveness in a particular sector are subsequently "punished" with the loss of the preference. In response to this criticism, the Commission's October 2004 memorandum notes that "graduation is not a penalty; it is a sign that the GSP has successfully performed its functions" (EC, 2004f). This interprettation is certainly subjective, but the Commission also implicitly recognized the limitations of this mechanism in previous regulations by introducing significant changes in its new proposal.

Another problem with the GSP is that it is mostly used by larger companies. As Stevens and Kennan (2004b: 5) note from the ACP experience, "in the main, successful, established exporters are 'able to work the system'". For Latin America, the data base is weak and analysis relies on impressions from the reports prepared by Latin American specialists for this study on the use of the GSP in Bolivia, Honduras and Paraguay[44]. One clear message from these reports is that information on the EU GSP is limited and mostly accessible to major corporations and / or business associations representing their interests. In any case, it is interesting to note how little public debate there has been in these countries, when compared with other international trade matters. This reflects a lack of knowledge but also, perhaps, the perception that this preferential scheme is of little consequence.

One of the worst problems with the GSP is not technical, but political. That is, the fact that it is available to almost everyone. Indeed, Stevens and Kennan (2004b: 2) argue that benefits decline as same terms become available to all potential suppliers. The EU has yet to deal with this issue –called preference erosion— in a systematic manner, although it has been cited in various policy documents as a problem to look into.

Case Studies from Latin America[45]

These problems are generally common to all developing countries, so it would be useful to review particular experiences in Latin America. For that purpose, two countries were selected for more in-depth analysis. The first case is Bolivia, one of the poorest countries in the region, a relatively important aid recipient (with Official Development Assistance/ODA representing close to 10% of GDP), an economy still based on largely traditional commodity production and without direct access to the sea (which contributes to increased transport costs). Costa Rica, the second case, has a fairly high GDP per capita and one of the highest human development indices in the region. It does not receive much aid and its economy has gone through an extraordinary transformation resulting in a significant diversification of exports. Both countries have a small domestic market (with respective population of 8 and 4 million) and both benefit from the GSP drugs regime.

main reasons for under-utilization of existing preferences: "Some of the current features of rules of origin go against the very concept of trade facilitation" (p. xi).

[44] The evaluation of the Colombia GSP utilization (Gonzalez, 2003) confirms this trend implicitly.

[45] Latin American specialists were asked to prepare brief reports on the EU GSP in their countries: Bolivia, Honduras and Paraguay. For this paper, we chose the Bolivian study because it had the most complete analysis and because it is one of the region's poorest states. We wanted to contrast it with a case study of a more successful exporter, Costa Rica, for which we received considerable information from the Costa Rican embassy to the EU in Brussels –for which we are specially grateful—, which was complemented by other independent data.

Case Study 1 – Bolivia

With a per capita income of somewhat under $1,000, Bolivia is the second poorest country in Latin America (after Haiti), with over a half of its population living on less than US$2 a day, and one of the highest infant mortality rates in the world. In the last two years, the country has entered into a serious economic and political crisis. Bolivia has been a beneficiary of the European Union's GSP-drugs trading regime since its instigation in November 1990, as part of EU policy against the drug trade.

Ever since 1985 when a rigid structural adjustment programme was applied, Bolivia has maintained a relatively open trade regime with very few restrictions on imports and with no subsidies on exports. As a result of its geographical location in the centre of South America, Bolivia acts as a sort of hinge between two customs unions: the Andean Community of Nations (Bolivia, Colombia, Ecuador and Venezuela) and MERCOSUR (Argentina, Brazil, Paraguay and Uruguay).

Table 6
Trade Balance of Bolvia with the EU, 1993-2002 (mlns US$)

	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002
Exports to EU	270.6	290.3	305.2	271	312.4	307.8	285.4	249.7	136.9	94.3
- as % of total trade	38.1	29.1	29.3	23.9	26.7	27.8	27.2	20.0	10.7	7.2
Imports from EU	226.1	137.9	276.6	253.9	284.7	330	193	182.6	160.6	148.1
Trade Balance	44.5	152.4	28.6	17.1	27.7	-22.2	92.4	67.1	-23.7	-53.8

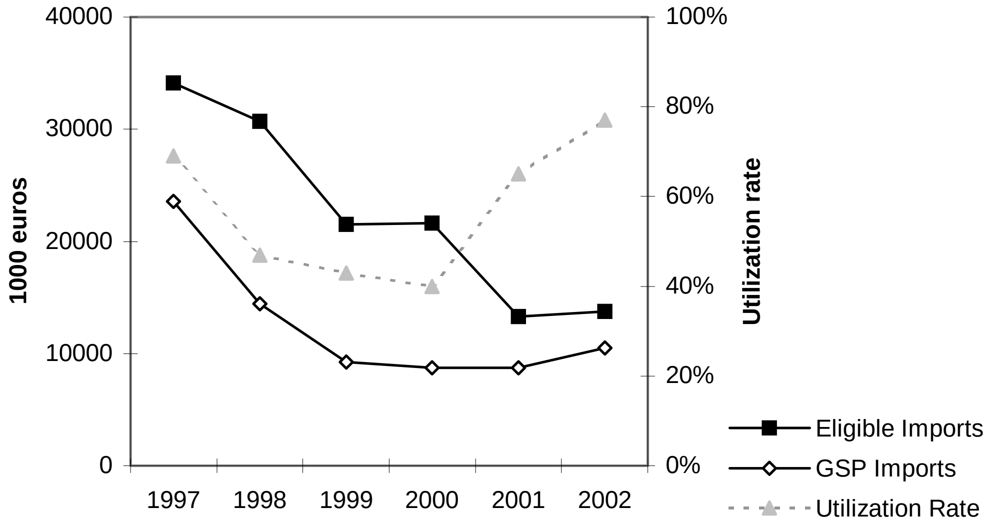
SOURCE: Pacheco (2003), from the National Statistics Institution (INE), Bolivia.

The country's commitment to free trade is therefore not in doubt. Yet its subsequent poor trade performance has been disappointing, particularly with regards to the European Union (Table 6). Throughout the 1990s, there was a marked decline of Bolivian exports to the EU. In 1993, 38.1% of all exported goods went to the EU, but by 1998 that figure had fallen to 27.2 percent and in 2002 the corresponding figure was only 7.2 percent. Since 2001, Bolivia has actually been running a trade deficit with the EU. This is despite the fact that the vast majority of Bolivian exports fall under the GSP.

As is clear in Graph 4, Bolivia's utilisation of the GSP has varied considerably over the period 1997-2002, although on average it has been relatively high (60%). In terms of its effective utility –preferential exports/total exports to the EU— this instrument has not been that beneficial (average 7% per year) for Bolivia's trade development. This reflects the fact that in absolute terms, Bolivia's preferential exports to the EU have been falling steadily, from close to 24 million euros in 1997 to slightly over 10 million euros in 2001, with a slight recovery in 2002.

What has happened? Firstly, overall sales to the EU have fallen by over 40% in this period, reflecting dramatic declines in exports of several of Bolivia's major products (see Graph 5), most notably in the jewellery (-75%) and mineral products (-48%) sectors. Significant decreases were also evident in two other sectors: grains, seeds and fruits (-92%) and coffees, teas and spices (-65%). Together, these four sectors accounted for a fall of 130 million euros between 1997 and 2002.

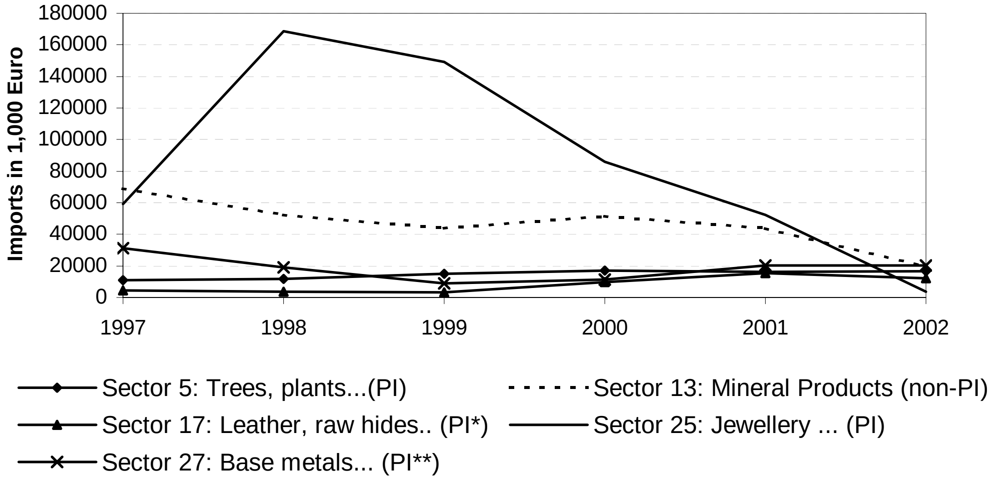
Graph 4
Bolivia- EU-GSP imports, 1997-2002



SOURCE: Prepared by authors based on data provided by DG Trade, European Commission.

All of these sectors benefited from the GSP drugs scheme except for mineral products (although the coffee and tea sector lost this status in 2001 as a result of "zeroing out" of this tariff). Only in three important sectors were there any positive trends during this period, but the total growth was only 17.8 million euros.

Graph 5
GSP Statistics-Imports from Bolivia by sector, 1997-2002 (5 most important sectors)



SOURCE: Prepared by authors based on data provided by DG Trade, European Commission
Notes: PI refers to Preferential Import; non-PI to non-preferential import.
* Preferences were not available in 1999.
** Preferences excepted in 1998 and 2002.

Total Bolivian exports have been running at practically the same levels for 20 years now. Moreover, lack of diversification means that 11 products constitute 80% of exports by value, with 76% of exports consisting of primary products. The most important export goods towards the EU market are minerals, which in 2002 represented 48.1 percent of the total. Since 1997, Brazil nuts have been exported on a significant scale. Other exports which contain a degree of value added, such as leather, textiles, wood products, jewellery and handicrafts, are not very significant.

This unsatisfactory performance is despite the existence of several national programmes and institutions that try to stimulate Bolivian exports (such as RITEX and CEPROBOL).[46] The European Union has been trying to support these institutions, and CEPROBOL has recently received a 1.2 million grant from the EU, specifically with the aim of enhancing trade flows and investments between Bolivia and the EU. One area where help is clearly needed is to compensate for the lack of awareness of the importance of regulatory compliance, standardisation, and quality certification. In 1999, Bolivia had only 4 ISO 9000 certified companies. It remains to be seen how effective this financial support will be to the CEPROBOL, although judging by past performance of this kind of initiative, its impact both on export volumes and poverty reduction will probably be limited.

Why has export performance been so poor, despite the clear commitment of the Bolivian political class to orthodox reform and macroeconomic stabilization? From the mid-1980s the Bolivian government liberalised its economy in line with the recommendations of the World Bank and the IMF. Yet foreign capital never arrived in the expected quantities. The foreign investment that has taken place has generally focused on two sectors: hydrocarbons, encouraged by the discovery of gas reserves, and telecommunications, following the opening of the market to competition at the end of 2001. Unfortunately these investments, although significant in the national economic context, do not generate much employment and have no major multiplier effects. More importantly, the lack of transparency in the way the government handled international energy contracts and planned projects in this area, provoked massive and violent demonstrations which lead to President Sánchez de Losada's fleeing Bolivia in the fall of 2003. The new government, heavily pressured by social actors, has tended to favour a nationalist focus, contributing to a significant reductions in foreign investments.

On the other hand, investments in manufacturing industry and agri-business represent only 11% of total foreign investment. In sum, foreign investment has contributed little or nothing to the diversification of the Bolivian economy. If anything, it has helped consolidate the dominance of the primary sector in the export structure of the economy.

Despite an unfavourable international context, over the decade of the 1990s total export volumes increased by 57 percent. Some sectors showed marked dynamism. Agricultural exports, for instance, increased at a rate of 10.3 percent, compared to a world average of 3.1 percent (Loza, 2002: 185). But in a good example of the phenomenon of "running to stand still", the terms of trade have shifted sharply against Bolivian exports over the last twenty years. In an extensive analysis of the factors affectting Bolivian's terms of trade, Loza (2002) observes that even the growth of non-traditional exports, such as Brazil nuts or soya, has not diminished Bolivia's vulnerability to volatile and declining terms of trade. The only policy likely to succeed in reducing risk, he concludes, is the development of manufacturing exports.

Another important element which goes a long way to explaining the apparently poor export performance is that Bolivian frontiers can be considered as a leaky sieve –in 1990, the Bolivian government lost about $109 million per year in revenue through contraband–. By 1997, the estimated annual amount lost had risen to about $430 million (Kaufmann, Mastruzzi and Zavaleta, 2002:16).

One way forward could be to follow the example of the German GTZ in its extensive and long-term involvement in the formation of a successful federation of cocoa producers

[46] Much of the following data comes from Inter-Service Task Force project documents for Bolivia (no date).

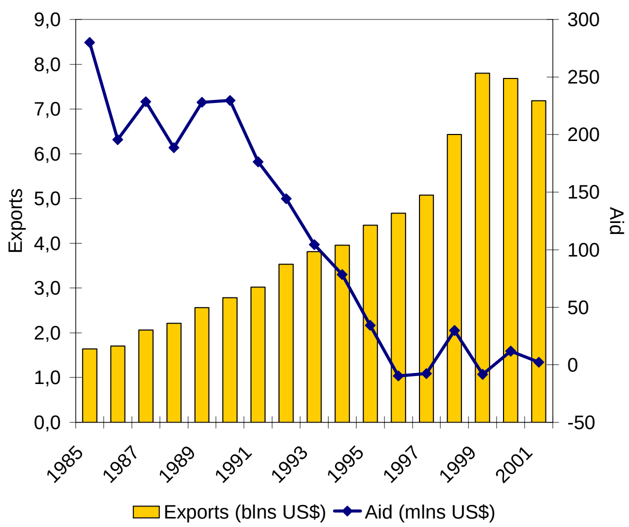
at El Ceibo. The producers of El Ceibo found their market niche in fair trade chocolate and cocoa, and were helped by the GTZ which provided marketing and technical help as well as funding. A high degree of co-operation was achieved because the project built on a tradition in Bolivia of community organisations which, following the Revolution of 1953, were created 'to act as a bridge between local people and government and other external institutions" (Bebbington, 1996). Even so, it is not clear whether this would serve as a model for the broader economy.

However, in the case of such a fragmented, racially-divided, community as that in Bolivia, it seems difficult to conceive that trade initiatives are the best policy tool if poverty reduction is the priority, although for this aid to be effective, significant efforts would be needed to buttress local institutional capacity. More direct aid to the most deprived (principally indigenous) communities is required. Despite increased budget allocations for education, and some improvement in enrolment rates, by the early nineties well over one-half the adult population were functionally illiterate. Basic health services are also woefully inadequate. Infant, child and maternal mortality rates are among the highest in Latin America, while vaccination rates for children have remained stagnant or even worsened since the late 1980s (Kaufmann, Mastruzzi and Zavaleta, 2002:18). Well-targeted aid complementing market preferences seems to be the way forward for Bolivia.

Case Study 2: Costa Rica

This case study illustrates one of the principal paradoxes of the current GSP system as applied by the EU: through the system of graduation, the GSP punishes countries which achieve high rates of export growth in sectors where preferences are made available. Although its GDP per capita is close to the average level for Latin America, in terms of human development, Costa Rica is often considered a success story. On examining indicators like life expectancy, infant mortality or literacy, Costa Rica has attained objectives far above the levels which correspond to its income per capita, standing as it does in the 41 place of the UNDP's HDI. As a consequence, the country is no longer a priority for donor countries, and has been gradually losing aid. For this reason, Costa Rica has become increasingly dependent on exports as a way of generating foreign exchange (see Figure 7).

Figure 7
Costa Rican Exports of Goods and Services and Aid Receipts, 1985-2002



SOURCE: World Bank WDI online.

In many respects, Costa Rica has managed this transformation well, and can be considered a success in the promotion of exports. For instance, between 1985 and 2000 Costa Rica's exports to the United States, its principal export market, grew five-fold, from $1.1 billion to $5.5 billion. Along with this high rate of export growth, there has been a marked decrease in the dependence on primary products, and a sharp increase in high-technology exports, from practically negligible levels in 1985 to over 35% for exports to the United States (UNCTAD, 2002). This has principally been due to the success of Costa Rica's foreign investment promotion agency, CINDE, in attracting export-oriented FDI, including a micro-chip plant owned by Intel which alone was responsible for $1.676 billion of exports in 2000. In agriculture, too, there has been a significant diversification away from the traditional export crops towards products such as cut-flowers and plants. The principal incentive behind this process of diversification has not been the shift towards a more liberal trade regime, but rather the difficult international context for Costa Rica's main export crops: the rapid emergence of Vietnam on international markets as a coffee and rice producer, and problems of access to European markets. This has obliged many Costa Rican producers to switch away from traditional crops.

A result of these structural changes and despite popular perceptions to the contrary, is that Costa Rica is no longer a predominantly agricultural economy. According to data from the Costa Rican Household Survey, only 15.6 percent of the economically active population now work in the agricultural sector. However, more than a third (37.7%) of the people that fall under the national poverty line are still employed in the agricultural sector, a fact which denotes the importance of rural areas in any strategy to reduce poverty (Estado de la Nación, 2002: 177).

Despite Costa Rica's undoubted successes in human development, it would be wrong to give the impression that the country has resolved the significant social problems related to poverty. Indeed, the Achilles' heal of the Costa Rican "model" of social development is that it has been unable to make much progress in eliminating poverty. The country has suffered what is seemingly a structural level of poverty which rarely has fallen below 20 per cent of the population on the basis of the national poverty line. Poverty is especially serious in rural areas, where one in four families falls under the poverty line.

Moreover, the international context for Costa Rica has not been favourable in recent years. Since the year 2000, it has suffered its lowest growth rate in the last twenty years. Total exports have fallen by 22 percent from the year 1999 to 2001, and exports to the EU have fallen from $1.4 billion to $0.8 billion. The country is confronting an extremely adverse external market for its four principal export products –coffee, bananas, electronic chips and tourism– and the terms of trade for products like coffee are currently at historic lows. The situation in the coffee market is particularly worrying from the point of view of the poverty reduction –over 90 percent of the coffee producers are categorised as "small holders"– (Estado de la Nación, 2002:180).

Within this broad and difficult context, and contrary to the criticisms of the European Commission that Latin American countries have not been taking sufficient advantage of the market preferences made available, Costa Rica has managed a high rate of utilisation under the GSP+ --81.2% in 2001--[47]. It is thus doubly unfortunate that an important sector for Costa Rica has recently been removed from the GSP system under the aforementioned graduation mechanism. Ironically, the balance of trade of Costa Rica with the EU had already shown symptoms of deterioration prior to this move. Moreover, the sector affected by graduation, Sector V ("Live plants, vegetables and fruits") includes many products which are produced principally by small holders, and employs migrants, women and poor workers. The removal of the GSP+ benefits will imply an 8 percent tariff in future, in a sector where there is considerable competition from

[47] It is true that a decrease of preferential exports can be detected for all sectors (except textile and industrial products) but this decrease is due to a decline in eligible trade due to the zeroing of the MFN duty of 198 tariff lines (including coffee).

neighbouring countries such as Guatemala and Colombia.

The Costa Rican government believes that the Commission's decision to graduate the sector is unfair, on a number of grounds:

Ÿ First, graduation has occurred because just one of the products in the sector, (pineapples) has exceeded the 25% limit of total EU-imports. Yet the EU's own regulations do not make it clear whether graduation occurs when just one pro-duct in the sector surpasses the pre-established limit, or whether all the products in the sector have to exceed the said limit. Moreover, most pineapple production is in the hands of a major US-owned exporter, while the rest of Sector V is characterised by small-scale producers who will suffer the consequences of graduation. This clearly goes against the spirit of the GSP+ as an instrument for poverty reduction. The Costa Ricans argue that some kind of flexibility in the application of the rules should be possible in these cases.

Ÿ There are a number of technical discrepancies about the application of graduation. For instance, graduation has been applied on the basis of trade data for the years 1997-99, not the most recent data, which, given the deteriorating trade balance between Costa Rica and the EU in the intervening period, the Costa Ricans consider as unfair. In addition, in an example of the unilateral way in which the preference regime is managed, the Commission insists on using EUROSTAT data for the purposes of evaluating "graduation", and has refused to acknowledge the validity of Costa Rican statistics on exports.

Ÿ When the graduation system was first introduced in the mid-1990s, the Commission let it be known that "graduation" would only be applied gradually, in the sense that the higher standard GSP tariffs would only be slowly phased in, in order to minimise the negative effects of graduation for producers. In the intervening period, however, this has been overlooked, and graduation will, according to recent declarations, be applied immediately.

Ÿ Over the last four years the European share of Costa Rican exports has fallen from 21.3 percent to 16.4 percent, compared to the 60 percent of exports destined to the US. One of the objectives of the GSP+ has been to counteract these tendencies of the progressive marginalisation of EU trade with the region. Sudden graduation will only contribute to enhancing these trends.

Ÿ Finally, according to the Costa Ricans, the political dimension of the GSP+ seems to have been forgotten. The scheme was extended to the Central American countries to help the region reach its developmental goals, negatively affected as it has been by the drugs trade, severe flooding and a very difficult international environment.

Lessons from case studies

There are some emerging lessons from this case study analysis. A first lesson is that the GSP is used more than is apparent. However, at the same time, the GSP, as it is now applied is of most benefit to those who least need it. Globally, trade dynamos such as China concentrate close to a third of the benefits on offer through the EU's preferential scheme, while Bolivia's share of the benefits –a country with greater obstacles to world economic integration— is minuscule. Is the GSP supposed to reward global traders or countries that are struggling to compete in the international market? This issue should be at the heart of current efforts to reform this policy tool.

Nevertheless, the Bolivian case also shows that it is better not to expect too much from tariff preference regimes. If a country has critical internal political, social and economic problems, there is little the GSP or any similar trade instrument can do to foster growth, development or poverty reduction. In other words, the GSP may only work if the conditions are right, but determining what these are is not easy.

At the same time, is it right to take away GSP benefits from a poverty-prone sector because a country has been successful in developing it? This seems to be what happened in Costa Rica. The rigid application of current criteria leads to results which are inconsistent with the poverty objective of EU development policy. How can the GSP regime be designed and/or implemented so it can take account of these concerns?

Finally, the differences between the experience in Bolivia and Costa Rica make it clear that the GSP's effects may vary considerably depending on local conditions. But, as the GSP is applied –theoretically at least– in the same way to all developing countries, it is difficult to take account of these variations.

Conclusions and Policy Recommendations

The purpose of this policy paper is to analyse and propose ideas about how the European Union could have a greater impact on reducing poverty through its trade policy, in conjunction with other policy instruments. For that goal, and regardless of what the new Generalised System of Preference scheme set to come out in 2005 looks like, it is useful now to analyse the poverty effects of EU preferential schemes. An overall premise of this study is that this instrument has had at best a limited impact on the lives of the poor –particularly in rural areas— in Latin America.

The partial and incomplete information available suggests this premise is correct. Indeed, the empirical evidence reveals cases in which the potential of the GSP to benefit the poor and excluded is demonstrated. Unfortunately, we know little about why this trade policy tool seems to serve the poverty goal sometimes, while in other circumstances it does not.

This reflects a major problem surrounding the preferential regime: the lack of information about how it has functioned and what are its main results let alone what impact it may have[48]. This is partly due to the unilateral nature of the instrument which results in the EU not being accountable to the beneficiary countries nor even to its own citizens. This is contradictory given the Community's numerous statements about the importance of the principles of partnership and ownership in the development policy process. In that sense, the GSP is an anomaly, but this does not mean that it should be eliminated, rather that it needs some significant changes that go beyond technical "tinkering". In some ways the new scheme may be addressing this problem, but as occurred with earlier versions, it is entirely the result of internal bureaucratic decision-making, with absolutely no consultation of the key stakeholders.

Nevertheless, even if it were possible to overcome the informational problem, it is necessary to do more than just facilitate data regarding the overall results of the preferential regime. Available data does not allow for detecting a clear link between the GSP and poverty reduction. Presently, it is only possible to tell whether benefits are concentrated more on the better off or on poorer countries, and if the sectors which are benefited are those most likely to positively affect the lives of the poor and excluded groups. Only with deeper micro-level analysis (which goes beyond the mandate for this paper) would it be possible to determine this with a minimum of rigour. For that purpose it should be recalled that there has never been an evaluation carried out on this instrument and made publicly available.

In the meantime, the global and regional trade system is changing rapidly. In this context, shifts in the preferential access agreements by themselves are unlikely to bear much fruit. The main process to watch is the WTO Doha Round. Although this seems stuck for the time being, it includes key issues of relevance to special and differing treatment of developing countries. The ongoing negotiations to create a Free Trade Area of the Americas (FTAA) are an outgrowth of NAFTA and, if successful, will radically change the panorama in Latin America. As free trade agreements proliferate in the region, the GSP system will surely become less relevant. Some authors, such as Giordano (2003) and Salafranca (2001) propose Association Agreements for all Latin American countries with the EU to compensate for this situation. The EU is gradually moving in this direction, with agreements already signed with Chile and

[48] In fact, in the process of preparing this policy paper, the researchers faced this limitation constantly. One of their first discoveries was that information about the GSP is not readily available. This is not just a problem for researchers, but is also faced by the beneficiary countries themselves. For instance, when the SIECA (2002) carried out a study on the use of the GSP in Central America, it could not even get access to Community data, so it had to rely on information from each of its member states (which may contradict that which the EU has).

Mexico and ongoing negotiations with Mercosur (although these once again failed to advance in the October 2004 rounds). The market access that these countries gain would certainly be beneficial.

However, according to the Community, the Andean and Central American countries are not currently in a condition to assume a free trade agreement with the EU. Thus, for these countries the GSP will remain the only alternative for the coming years. Yet, the tool has proved to be a blunt one, even in narrow terms of promoting exports; as one commentator puts it, zones like Central America are caught between entering into an asymmetrical but eventually reciprocal trade agreement with Europe and a preferential system with constantly eroding benefits (Jessop, 2004).

The lack of success of the GSP in contributing to poverty reduction in the Latin American countries can be attributed to various reasons. As pointed out in the last section, some of these reasons are due to domestic social and economic conditions, about which the European Union's ability to influence change is limited. But other factors which explain the poor performance of the GSP and enhanced GSP as a poverty reduction tool are clearly related to the way in which the preferences have been designed and implemented. Chief among these weaknesses are the lack of permanence in these preferences; poor knowledge of the European market; a failure to provide sufficient help to strengthen indigenous technological capacity and facilitate access for small-scale producers; and excessively strict rules of origin. A number of measures could be implemented to make the benefits more durable:

- In the first place, the graduation system needs to be thoroughly revised, both conceptually and with regards to its implementation. Although there may be a justification for some kind of system of graduation to avoid the lion's share of the benefits of GSP being taken by a few more dynamic exporters, in its current form the system often functions contrary to the objective of maximising poverty reduction. For instance, if the system of graduation is to be retained, it would be better to impose a system based on product data, rather than sector data. If the objective is truly poverty reduction, then the Costa Rican complaint on this point seems well-founded –it is unfair to graduate an entire sector on the basis of the activities of a few multinational corporations. The proposed new scheme seems to address these concerns by reducing negative effects for smaller and poorer countries that may have one or two dynamic exports to the EU.

- Secondly, the GSP scheme could be consolidated on a more permanent basis, without the revisions to which it is currently subject. The enhanced GSP regime has been changed no less than three times since its creation, in 1994, 1998, and again at the end of 2001, and another revision is due at the end of 2004. This situation obviously undermines any positive incentives to investment in preference-receiving sectors. If benefits were extended on a, say, fifteen year basis, the EU would give a clear signal regarding the seriousness of its intentions to help Latin American countries strengthen their exporting capacities. In this regard, it is disappointing to note that the Commission's October 2004 memorandum returns to the idea of a three-year scheme, whereas the July 2004 guidelines mentioned a 10-year period.

- In the same sense, safeguard clauses need to be redrawn, to reduce the degree of discretion in their application. Significant investment into export-oriented sectors in these countries is unlikely in the context of uncertainty produced by the highly discretionary way in which the policy is implemented.

- Poor knowledge of the European market has traditionally been tackled by trade-fairs, market studies, and support to comply with technical standards, etc., and in this area more support could be given to lower income Latin American countries. There are a number of initiatives in this sense in countries like Bolivia, but currently they are under-funded and not well-integrated with the overall development policy. More financial resources would help, but as important are efforts to mainstream trade concerns in the aid management and improve understanding about development cooperation in DG Trade. In sum, for the GSP to contribute to poverty reduction, deeper coordination is required; the Inter-Service Task Force on Trade and Development is a good step in this direction, but its efforts should be broadened. In addition, the Commission ought to work more closely with the member states in this area. At present inter-institutional communications on the subject are not systematised.

- With regards to the point on excessively strict rules of origin, there is a notable lack of transparency in the making of these rules. This might suggest that EU policy is prisoner to special interests and business lobbies. But Brenton and Manchin (2003) argue that this may not even be the case -that the rules of origin do not obey any political or even economic logic and are imposed simply because of precedent. Revision of these rules may therefore be easier than one might initially anticipate, although as Stevens and Kennan (2004: 4) correctly note, "it will always be very difficult to set the rules so that they are 'just right'"; for that reason, they suggest "preference-givers should always err on the side of cautious liberality". On this point, the Commission has advanced in its recent proposal in the sense of making these rules more flexible and encouraging regional accumulation.

- Finally, more research is required into the links between export promotion and poverty reduction if programmes like the enhanced GSP are to be justified. In-depth studies along the lines of the one produced by the Costa Rican government regarding the link between export growth and poverty impact need to be carried out. The EU could even provide support for these efforts as a way of increasing local ownership.

In the final resort, of course, the issue of what to do with the GSP is a political one. It might be considered that the political advantages of maintaining the current GSP system as it stands outweigh the costs. If so, a reformist agenda should be considered, encompassing some of the points that have been raised here and elsewhere.

This paper ultimately calls for a more poverty-focused GSP, that is, a scheme that includes proactive measures aimed at reducing poverty (which does not just mean that it should be more focused on poorer countries). This might involve not only implementing some or all of the suggested changes, but also finding ways to integrate the preferential scheme more closely with development cooperation programmes. As one Inter-American Development Bank study noted recently, "there is no doubt that a trade and cooperation nexus is a desirable objective in initiatives designed to deepen North-South relationships" (Devlin, et al, 2002: 112). Against a backdrop of rising poverty, social and political tensions in Latin America, it seems clear that the EU needs to improve both the quantity and quality of the aid provided to the region.

Trade promotion is no substitute for good quality aid which can have a much more direct impact on the poor. However, the real challenge is to make aid and trade work together against poverty[49], with the Generalised System of Preferences as a key component of EU policy; the Commission admits as much in its recent policy statements (EC 2004e/f). Development cooperation by itself will never be sufficient to foster the rates of growth and broader development that result in a significant reduction in poverty and inequality. In this sense, the GSP (with or without the special arrangements) could be used to demonstrate the EU's pro-poor orientation to Latin America, provided changes are introduced and only if it is well-integrated with other development policy instruments.

[49] This is one of the many conclusions of a High-Level Round Table on Trade and Poverty held at UNCTAD XI, Sao Paolo, Brazil, in June 2004: "International trade is an essential component of the comprehensive set of global reforms that are required. Nevertheless, there should be no substitution of aid for trade. Rather, the question is how to make trade and aid mutually support each other, and how to use aid more effectively for trade" (UNCTAD, 2004c).

In sum, this text does not propose a simple solution to what is a complex issue. That would not be viable or helpful to policy-makers wrestling with many complexities (although they would prefer easy answers). In the end, our main contribution may be more modest: to put this matter on the public agenda, contributing to a broader discussion that, in the end, ought to lead to improved policy.

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