Overseas Development Institute

Briefing Paper

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NEGOTIATING THE FOURTH LOMÉ CONVENTION

The renegotiation of the third Lomé Convention began in October 1988 and is scheduled to be concluded at the end of this year. It is one of the most important elements in the EC's formal Community-level development co-operation policy. As such, it sets the tone for EC-South relations and, through its trade provisions, exerts a powerful influence on the economies of its Third World signatories. Among the more prominent issues in the negotiations are the linking of aid with structural adjustment, the role of trade preferences and the impact of completing the EC internal market in 1992.

The Lomé Conventions link the Community with the 66-member ACP group, which includes all independent African states south of the Sahara and most of the former European colonies in the Caribbean and Pacific. The fourth Convention has a particular significance because it will overlap the completion of the EC internal market in 1992 and the implementation of the Uruguay Round of multilateral trade negotiations.[1] Both developments are likely to alter (and probably reduce) the trade preferences currently received by the ACP states.

There is a good deal of similarity between each of the Conventions, which are detailed and wide-ranging documents. The negotiations tend to focus on a limited number of proposed innovations that may either extend the scope of the Convention or alter the orientation of existing provisions. This Briefing Paper reviews the standard features of each Convention in the Boxes and discusses in the main text the more contentious features of the current negotiations. Although it focuses on the impact of EC policy on one group of developing countries (ldcs), it is important to bear in mind the possibility that some changes favourable to the ACP could be damaging to other ldcs and therefore of debatable value for the Third World as a whole.

From Lomé III to Lomé IV

When the first Lomé Convention was signed in 1975 it was hailed as a step on the road to a 'new international economic order'. Yet the economic situation of many ACP states has since deteriorated. This has conditioned profoundly the environment within which Lomé IV is being negotiated, with the EC questioning the utility of trade preferences and seeking greater influence over the economic policies of some ACP states. The change in the EC's approach, already evident in the Lomé III text, has been reinforced in the period since the Convention was signed.

Implementation of Lomé III

The first Convention accorded to the ACP states an unusual degree of freedom in setting aid priorities; whilst the EC retained the ultimate 'power of the purse' it could not impose its views.

But Lomé III represented an explicit attempt by the EC Commission to alter the balance of responsibilities. It sought 'a political dialogue between external providers of funds and local decision-makers' over development strategy. Its stated preference was that aid should be used in support of food sector strategies. Other innovations included sections on cultural co-operation, drought and desertification control and human rights.

Few of these innovations have yet worked their way through into significant actions. The one area in which there has been substantial progress is on the first major stage of aid delivery: the programming of that part of the Lomé III aid budget allocated to a National Indicative Programme (NIP) in each ACP state and sub-region (see Box 2). This has been completed and it is clear that, in broad terms at least, the Lomé III emphasis on sectoral concentration has been put into practice. Around three-quarters of the NIPs make rural development, broadly defined, the main sectoral concentration of Lomé III aid.

However, programming is only the first step in the process of aid implementation and it will not be certain for some time how far in practice Lomé III will differ from its predecessors. The activities covered by the NIPs range from projects and technical assistance aimed at increasing food security to activities that would have been described in previous Conventions as infrastructure, such as the construction and maintenance of rural roads.

The NIPs also suggest that the EC may have succeeded in its desire to engage in policy dialogue. Each ACP state has indicated a range of domestic policy measures that it will take in support of the priority sectors. However, the policy commitments made by the ACP states are couched at this stage only in very general terms, such as 'incentive prices for agriculture', 'institutional reform' and 'adequate supplies of inputs and credit'.

Export Decline and Debt

Implementation of Lomé III has been affected strongly by the deterioration in the ACP's external environment, which has been dominated since 1980 by the sharp fall in world prices for their most important export commodities and the build-up of debt (which is not negotiated in the Lomé context as it is deemed an EC member state responsibility). The problem has pressed most heavily on Africa. This is partly because the Caribbean, and to some extent the Pacific, are insulated by the Sugar and Banana Protocols for their main primary commodity exports.

These commodity price falls have had a direct effect upon the Stabex fund (Box 2), which has been heavily overdrawn. In 1988, for example, the funds earmarked for Stabex (at Ecu 255m) were less than one-third of the ACP's initial claim of Ecu 803m and under one-half of the Ecu 579m which the EC accepted as justifiable. The shortfall has been reduced but not resolved by the transfer of Ecu 120m from various reserves and unspent funds from previous Conventions.

The Community has responded to ACP problems through a special programme under which Ecu 500m is being made available during 1988 and 1989 in the form of quick-disbursing aid for import support to the poorest and most debt-distressed African states. The funds have been obtained partly through the reallocation of existing Lomé III resources and partly through new assistance.

1. See ODI Briefing Papers, *The GATT Uruguay Round*, November 1987 and *Developing Countries and 1992*, forthcoming November 1989.

Box 1: The Basics of Lomé

Membership

The first Lomé Convention was negotiated because the enlarged EC had to establish a relationship with ldcs that lost Commonwealth preference when the UK joined the Community. The membership of the ACP was determined, in the words of an internal Commission document, by Europe's 'vocation for Africa' plus its obligations to the Caribbean and the Pacific under UK's treaty of accession.

Provisions

Each Lomé Convention lasts for five years (although one of the current negotiating issues is whether Lomé IV should last longer). Lomé I began in 1975. Lomé IV should begin in 1990 but like its predecessors it will come into force late because ratification by the EC and ACP states normally takes more than a year. This does not usually result in a hiatus: the trade regime can be continued under temporary regulations and there is a sufficient carryover of unspent funds from Lomé III to allow aid spending to continue as normal whilst the groundwork for the Lomé IV aid programme is laid.

The Conventions set the preferential tariff regime under which the ACP states trade with the EC. Since Europe is the dominant trade partner of most of the ACP states, the Conventions have a major impact on their external environment.

They also constitute the largest Community-level aid programme for developing countries. However, the aid provisions are less important than those on trade since only 10% of the aid provided by the European states actually passes through the Community institutions, and only part of this is channelled through Lomé.

Negotiation

Much of the detailed work is undertaken by the EC Commission on the one side and committees of the ACP ambassadors in Brussels on the other. These are punctuated by periodic ministerial councils which provide milestones to indicate progress and serve (particularly at the later stages) to hammer out difficult issues. The first ministerial council after the launch of the current round was held in Brazzaville in February 1989. The second was held in Brussels in June and the next is scheduled for late October; it will not be the last.

The common shorthand of these agreements as 'Lomé Conventions' derives from the fact that all three have been signed in the Togolese capital of that name. There is nothing to prevent the next agreement being signed somewhere else, but for convenience it is known for the time being as Lomé IV.

The programme's significance is not just that it represents a small addition to the resources already promised but also that it may be a harbinger of a further change in the aid relationship beyond the shift in Lomé III. It has brought to the fore the relationship between the EC's Lomé activities and those of the Bretton Woods institutions.

The criteria for establishing the eligibility of African states were set in March 1988. One is that they must have introduced policies that are considered adequate to deal with their economic problems. By implication, an understanding with the Bretton Woods institutions is taken as sufficient evidence of such adequacy. About half of the ACP states have sought adjustment credits from the World Bank.

If a state has agreed a structural or sectoral adjustment loan (SAL/SECAL) with the World Bank then the EC money can be used for a general import programme. If no such loan is in place the EC will form a judgement as to whether policies with respect to a particular sector are adequate. If this is positive, funds will be made available for a sectoral import programme. The criteria on which such a judgement will be made are not yet clear. Experience so far suggests that the EC may have a positive contribution to make to dialogue over policies for the food sector but that there is resistance by some member states to general or sectoral import support to states that are in fundamental disagreement with the IMF or World Bank.

Issues for Lomé IV

There are two parallel sets of negotiations, as there have been on previous occasions. The first, and arguably the most important, is between the EC member states and the Commission; the second is between the EC and the ACP. On most of the prominent issues there are differences of opinion within the EC that have to be resolved before the Community can respond to ACP positions or formulate proposals of its own.

Trade versus Aid

During the Lomé III negotiations there was a dispute between the EC member states over whether to emphasise trade improvements or an increase in aid in their response to ACP demands. A similar dispute has arisen during the present negotiations. In both cases the Northern European states have tended to support an extension of the Convention's most valuable trade preferences on temperate agricultural goods (see Box 3) and in some cases, such as the UK, to be reluctant to accept a large increase in aid. The Southern European states, by contrast, have opposed major trade liberalisation (which poses a greater competitive threat to their producers) but have been more sympathetic towards a large increase in the volume of aid. These differences blocked negotiations on trade until mid-summer.

In July a compromise was reached within the Community. This proposes a modest extension to preferences on over 30 CAP products ranging from figs and cherries to cheese and rice. The principal limitation on the offer is that the preferences are restricted to a small volume quota. In the case of husked rice, for example, the EC is proposing to increase the quota by a mere 2%.

The principal remaining limitations on ACP exports of manufactures are the rules of origin. These establish the proportion of the final value of a product which has to arise within an ACP or EC state before the Lomé preferences become operative. The ACP argue, with justification, that the rules are too onerous, requiring an unrealistically high level of ACP input. The EC has agreed thus far only to minor changes in the rules. These will not overcome the principal objection, which is that they deter the initial establishment of export-oriented industries within the ACP.

Structural Adjustment

The EC wishes to relate Lomé aid more closely to structural adjustment activities in ACP states. 'Structural adjustment' is a particularly sensitive issue, both because of its association with conditionality and because it relates to the overall size of the aid budget for the next Convention. Most of the negotiations so far have been between the EC member states rather than with the ACP. The Twelve have disagreed both over the proportion of Lomé aid to be available to finance imports for those countries undergoing structural adjustment as opposed to conventional aid projects, and over the extent to which any such aid should be coordinated with the World Bank and IMF.

Some states, notably the UK and Netherlands, have argued that a very high proportion of Lomé aid should be available for structural adjustment in states where this is appropriate. Others, including Ireland and Italy, have pressed for the allocation of ample funds for more conventional activities. This issue is linked to the overall size of the aid budget, which is one of the last items to be negotiated.

The compromise reached within the EC is that funds for structural adjustment will be available via two routes under Lomé IV. The bulk will be drawn from a special fund which will be available as and when required by those ACP states engaged on an approved structural adjustment programme. Alongside this special fund will be the normal programmable NIPs which, as in the past, will be pre-allocated to each ACP state. The NIPs will normally be used for traditional project aid but the existing provision under Article 188 permitting some of the funds to be used for import support will be retained.

On coordination with the World Bank/IMF the EC has established a somewhat ambiguous line. This recognises the need to coordinate with the Bretton Woods institutions but, at the same time, asserts that Lomé transfers will have a separate identity. Since the present level of adjustment-related conditionality carries a considerable degree of external influence on national policies it remains to be seen how it can be squared with equal partnership.

The scope for the EC to influence the pattern of spending within each country's aid programme is limited. Its influence is greatest over funds that have not been pre-allocated to a state's NIP. These can be applied to activities that, in practice, favour countries pursuing policies with which it agrees. Hence the scope of the EC to link aid to negotiations with the Bretton Woods institutions will be influenced by the share of the Lomé IV package allocated at the start of the Convention to country programmes. The greater the size of any 'reserve' or of the 'special structural adjustment fund' in Lomé IV, the greater will be the scope to apply negative pressure on ACP states in disagreement with the Bretton Woods institutions by withholding access to a part of the aid to which they would otherwise have been entitled.

The Impact of 1992

The full impact of 1992 on the EC's trade partners is still far from clear.[2] Like other ldcs the ACP states must keep the EC's emerging plans under scrutiny to ensure that their interests will not be prejudiced.

Because of their preferential access to the EC market the ACP are in a somewhat different position from other ldcs. To a certain extent they might even benefit from an eventual 'fortress Europe' if they retain their existing preferences, since that might reduce competition from other third parties. By the same token, the removal of internal barriers to trade within the EC might increase competition for the ACP in their traditional markets.

There are two ACP exports which may be affected directly by 1992: bananas and rum. The most serious potential danger for the ACP states is that procedures used to give effect to the Banana Protocol of the Convention may become inoperable.

At present, ACP banana exports to Europe survive largely because they are given differential treatment in their traditional markets under the Protocol. The ACP banana exporters are Côte d'Ivoire and Cameroon (which sell to the French market), Somalia (to Italy) and the Caribbean (to UK). The implication of completing the internal market is that it will no longer be possible for the governments of the three preferential markets to exclude cheaper imports from their neighbours. In the case of some of the Caribbean states the increased competition could wipe out over 80% of their merchandise exports to the EC.

The EC and ACP have agreed, effectively, to defer a solution to the problem until after the Lomé IV negotiations. The existing Banana Protocol does not specify precisely how the regime will operate; it simply states that no ACP state shall suffer a deterioration in its access and advantages in traditional EC markets. It is proposed to retain this phraseology. Hence the 'real' negotiations will take place only when the EC has announced its proposals for marketing arrangements after 1992, at which stage it will be up to the ACP to ensure that they give adequate effect to the promises of the Banana Protocol.

In the case of rum, 1992 may bring benefits to the ACP. At present the ACP have a quota for preferential exports of rum to the EC, but this is informally sub-divided among the member states. After 1992 these national sub-quotas will no longer be operative. This raises the possibility that ACP exports to, say, the German market could increase.

Box 2: The Aid System

Although each Convention has a distinct aid facility there is no presumption that this will all be spent within its five year lifetime. Quick-disbursing facilities such as Stabex (see below) can be implemented after a one-year lag for claims and processing, but spending on conventional projects tends to get fully under way only towards the end of the Convention. By May 1989 74% of the Lomé III programmable aid had been committed but only 11% had been disbursed. The bulk of project spending tends to be completed within a decade of signature.

Most of the aid under Lomé is held in a **European Development Fund (EDF)**. There is a separate EDF for each Convention and, confusingly, their numbers are not the same as those for the respective Lomé. (This is because EDFs 1-3 held the aid of the Yaoundé Conventions and their predecessor). Hence, the Lomé I aid was held in EDF 4, while the Lomé III aid is in EDF 6 (Ecu 7.4bn).

Each EDF is divided into a **programmable** part (about four-fifths of Lomé III) much of which is used for conventional aid projects (eg a road or a village development), and a **non-programmable** part, used for Stabex, emergency aid and other facilities not allocated in advance to a particular state. The relative size of these two parts is determined during the negotiation of each Convention.

One of the innovations of the first Convention was the export-related facility of **Stabex**. This provides ACP exporters of certain specified commodities with a form of partial compensation when their export revenue from that commodity falls because of a decline in production or a drop in the world price. The transfer is paid to the government.

Stabex was designed for soft commodities, and from Lomé II has been accompanied by the **Sysmin** facility for minerals. This loan fund makes no pretence to provide full compensation for loss of export revenue.

Apart from these two facilities most of the Lomé aid is spent on conventional projects. But there also exists provision under Article 188 to finance imports; this has acquired a prominence in the discussion of structural adjustment.

The first step after the Convention has been signed is to divide up the total programmable part into slices for each state (and for regions). Then the EC and each ACP state negotiate a **National Indicative Programme** (NIP) that sets the framework within which the aid will be spent.

After the NIP has been agreed work can commence identifying and justifying the specific uses to which the aid will be put. When each project is approved an allocation of aid is **committed** to it and, as it is implemented and bills submitted, this allocation is **disbursed**.

The GATT Round

Within the GATT multilateral trade negotiations the EC has offered to liberalise its import regime on tropical products. Since the value to the ACP states of the Lomé trade preferences depends on their being accorded more preferential terms of access than are other third party suppliers to the EC market, any such generalised liberalisation is potentially of concern to them.

The EC offer on tropical products has been tailored to minimise its direct impact on ACP preferences. The ACP

2. The complex set of potential effects is described in the ODI Briefing Paper, *Developing Countries and 1992*.

Box 3: The Trade Regime

The Lomé Convention provides the ACP states with the most liberal set of trade preferences accorded by the EC to any group of developing countries. Yet the ACP have lost market share in Europe since 1975. There have been three principal limitations on the practical value of the Lomé regime to the ACP:

- ACP exports are concentrated on commodities that face low MFN tariffs, so the margin for preference is necessarily small;
- the reciprocal of this is that the ACP have limited capacity to produce some of the goods for which they have notionally liberal access;
- moreover, there are residual access restrictions on some products of particular interest to the ACP.

In terms of the practical value of the Lomé preferences, the ACP states' exports to the EC fall into three broad groups. The largest group accounts for over 70% of the value of ACP exports to the EC. These commodities enter the Community market duty-free, but so they would even without the Lomé Convention. The second group, accounting for a large part of the remainder, are products which enter duty-free under Lomé but do not do so under the GSP or MFN and do not compete directly with European production. Hence, the ACP states receive a tariff preference over other third party exporters to the EC.

The third category is the smallest in terms of ACP export value but is potentially the most significant. It consists of goods that are also produced within Europe for which European suppliers benefit from substantial protection. Most notable are products that fall within the Common Agricultural Policy, plus clothing and textiles that are controlled by the Multifibre Arrangement.

In the case of temperate agricultural products the ACP states benefit from a number of openings to the European market that are usually restricted by quotas, calendars or both. In the case of clothing the ACP states are not subject to the Multifibre Arrangement, though there have been a number of instances of 'voluntary export restraint'.

Such preferences are particularly valuable for the ACP for three reasons. First, in many cases they facilitate ACP diversification. Second, ACP exporters, like European producers, are protected against competitive imports from other third party suppliers. And, not least, ACP export earnings are increased by the artificially high prices in the European market brought about by the restriction of supply.

retain the right to be consulted on such matters. In most cases either the ACP states do not export the product in question or their competitors already benefit under the generalised system of preferences from terms of entry that are as good as those now proposed within the GATT.

The one product of major importance for the ACP where there will be some loss of effective preference is coffee. The proposed new MFN rate is 4%, compared to a GSP of 4.5%. Since coffee is exported by 38 ACP states the effect of the liberalisation will be experienced widely. And it comes at a time when the International Coffee Agreement, which had also provided some degree of protection to ACP exports, has collapsed.

The ACP states have asked for compensation for the loss of preference, but the EC is solidly opposed to this. The ACP have also sought a special temporary regime under which the EC will import specified quantities at a guaranteed minimum price; the EC has not agreed.

Membership

The EC has already indicated that it will welcome an application from an independent Namibia to join Lomé, but other extensions to the membership are more controversial. Haiti and the Dominican Republic have both applied for membership of Lomé IV. Neither is a recent former colony of an EC state, and their applications have given rise to serious internal negotiations within both camps. At issue are both the principle concerning eligibility (with fears that the Dominican Republic might set a precedent for other Latin American states) and specifics concerning the Rum, Sugar and Banana Protocols.

Conclusion

The Lomé Conventions have been in existence for fifteen years. Yet they have not represented a step on the road to a 'New International Economic Order' for the ACP. Many countries are now in worse shape than they were at the start. Although the EC and the ACP disagree over the relative importance of ACP policy failures, inadequacies in the Conventions, and extraneous factors such as the commodity price slump, the ACP's economic decline is one of two major factors that will influence the shape of Lomé in the 1990s; the other is the completion of the Single European Market.

The ACP's current economic distress is likely to reinforce the tendency for the EC to increase the policy conditionality of its aid. This is partly because the ACP are in a weaker bargaining position. The fact that they require a higher proportion of their aid to be quasi-balance of payments support inevitably carries with it a questioning of the economic policies that have given rise to the payments deficit.

Although the precise effects of 1992 on the ACP are unclear, the primary objective of the SEM programme is to develop Europe, not other countries. Thus a resurgence of confidence and activity within the Community may reduce the relative if not the absolute importance of Lomé. In the period of alleged 'euro-sclerosis', development policy was advanced as one of the more substantial vehicles for demonstrating European unity. A former Commissioner for Development, Edgard Pisani, even described Third World policy as a 'cornerstone of European integration'. It is symptomatic of the subsequent change that development is now not even the exclusive concern of one Commissioner. Manuel Marin holds the portfolios of both development co-operation and fisheries, the latter a subject of considerable concern to his native Spain, while another Spanish EC Commissioner, Abel Matutes is in charge of relations with the rest of the Third World outside the Lomé Convention's ACP Group. There are even some concerns that the ACP could be further 'crowded out' by a new centre of EC aid, trade and adjustment interest: Poland, Hungary and the other Eastern European countries.

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