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AFTER THE DEADLINE AND ON THE PULSE: THE EAST AFRICAN COMMUNITY EPA

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Overview

East African countries have last month concluded the negotiation of an Economic Partnership Agreement (EPA) with the European Commission (EC). The EPA is a free trade agreement that retains the duty free quota free market access for *substantially all trade* in goods based on the principle of reciprocity. It requires EAC countries to open up their borders to duty and tariff-free goods and services from Europe. This agreement has been hailed by the EU countries as being "what the doctor ordered" for these struggling economies. However, numerous studies posit that this unequal partnership will have disastrous consequences on EAC citizens.

Farmers will face increased competition from Europe's highly subsidized goods; citizens shall lose the benefits of most of the state-provided basic social services due to loss of government revenue; regional integration of the EAC markets will be threatened as well as the individual partner states' loss of policy space to protect, respect and fulfil their citizen's human rights.

At the end of 2007, under immense time pressure from EC deadlines and threats of reverting to the less favourable GSP (Generalized System of Preferences) trading mechanism, EAC Partner States initialled an Interim EPA. Controversial Issues within the Interim EPA text included, but were not limited to, the varying negotiation schedules, Most Favoured Nation (MFN) clause, stand-still clauses, restrictive rules of origin and, inadequate dispute settlement and safeguard mechanisms and many others.

The goods-only interim EPA came along with an agreement to complete negotiations for the comprehensive EPA which includes issues on services, intellectual property rights, government procurement, competition policies and others. However, the stakes remain high.

Where The Rubber Meets The Road

The potential impacts of the EPA remained a subject of heated debate during the negotiations. The EU and defenders of the agreement aver that the following three benefits will accrue from EPA:

One, EPA will open taps for the flow of European direct investments to EAC countries; Two, there will be a 'locking-in' of the trade liberalization process in these countries, which is good for competition and employment; and three, the restructuring of EAC economies, by combining a modification of the framework of incentives for economic agents (propelling them towards a more efficient use of resources) with financial and technical support of the EU.

However, in both EAC and other African countries as well as in Europe, many analysts have pointed out to imbalances and inequalities inherent in the EPA.
First, liberalisation of trade, of which EPA is the vehicle, is seen by the EU to be an end unto itself while EAC countries see trade as a means of attaining the broader goal of economic transformation and national development.

Second, the EPA aims at increasing the profit margins of European exporters, rather than lowering the prices to consumers and EAC importers

Third, there will be loss of revenue to EAC country governments, thereby undermining their efforts to provide basic social services, as a result of elimination of tariffs as advocated by the EU. A diversification of fiscal receipts envisaged to be able to accrue from these agreements would not in the immediate to medium term be able to compensate – especially given that the EU has made it clear that it is not disposed towards the calls from EAC partner states for new and additional resources under EPA.

Fourth, the EPA negotiations pushed EAC countries to liberalise their trade regimes at a 'sub-optimal' rate as compared to what they would do unilaterally.

Fifth, EPA in its current design would complicate and frustrate regional integration (by treating differently countries belonging to the same regional grouping e.g. Kenya, a member of the East African Customs Union, is treated differently from fellow EACU members Burundi, Rwanda, Tanzania and Uganda because the latter four are LDCs).

Sixth, EU opposes the strengthening of Lome reflexes, which inordinately focus the attention of EAC countries on obtaining preferences (in Brussels) as opposed to recasting their attention on building regional markets as a basis of integration.

Seventh, through the strict Rules of Origin, the EPA is a recipe for stifling industrial development of the EAC countries.

The EU has consistently emphasised the position that EPA is to be WTO-compatible, pointing out that any legal challenges to the agreements would threaten the preferential market access that EAC exports enjoy in EU markets. One of the key advantages of EPA would be that they provided long-term security for such access, free from the threat of any legal challenge at the WTO.

In a proposal on the issue at the WTO, the EC interprets the 'substantially all trade' requirement for free trade agreements to mean that liberalisation should cover a minimum of 90 per cent of total trade between the parties. In the context of the EPA it is argued that the 90 per cent threshold could be met with a simple average of the EU liberalising 100 per cent of trade (with transition periods for sugar and rice) and the EAC only 80 per cent – measured in terms of both tariff lines and by value of the imported

goods. With regard to the transition period in the EPA and the 'reasonable length of time' in which liberalisation should occur, the EC position has been that while tariffs on 'the bulk' of liberalised goods should fall to zero within 10 years, the 'exceptional cases' warranted some flexibility in EPA – especially the LDCs among them – in liberalising a limited number of sensitive goods over a timeframe of 15 years. As in some other areas of the EPA, the EC pointed to the asymmetry in the obligations as evidence that it had taken account of the development concerns of EAC countries.

The above position was tabled by the EC in September 2007 as an indication of the maximum 'flexibility' that it would be prepared to defend at the WTO, while EAC countries were required to present 'WTO-defensible' trade liberalisation offers in order to become a party to an EPA and benefit from continued preferential market access. Indeed, it is this position that was adopted in practice by ACP and EAC countries in the EPA and various interim EPAs, with some ACP countries even liberalising considerably more or over shorter periods of time.

Apart from the technical discussion on WTO-compatibility, the EU has also emphasised the development impact that liberalisation of inputs, certain consumer goods or medicines would have in terms of increased welfare of the population and competitiveness. EAC region was encouraged to identify where liberalisation would bring quick benefits or where more time was needed or which should be excluded from liberalisation altogether in view of fiscal considerations or the need to protect vulnerable industries.

Liberalisation

One of the key concerns in the negotiation of both interim and final EPA was to replace the previous system of non-reciprocal trade preferences provided by the EU under the Cotonou Agreement with one that was compatible with WTO rules. The deadline of December 2007 for the completion of EPA negotiations was driven largely by the expiry of a waiver for the Cotonou preferences secured from other WTO members at the Doha Ministerial in November 2001.

In order for the new EPA to be compatible with WTO rules, the key requirement was a need to comply with Article XXIV of the General Agreement on Tariffs and Trade (GATT), which stipulates that regional trade agreements must eliminate duties on 'substantially all the trade' within a 'reasonable length of time'. One obvious difference between the Cotonou and EPA regimes is that for the first time liberalisation obligations are reciprocal (i.e. requiring removal of tariffs on both sides).

Crucially, the term 'substantially all trade' has never been defined by the WTO. The Understanding on the Interpretation of Article XXIV of GATT 1994 provides that a 'reasonable length of time' should exceed 10 years only in 'exceptional cases', but the term 'exceptional cases' is undefined. Negotiations in the EPA on the issue therefore centred on differing interpretations of the what was required to comply with Article XXIV.

The Cotonou Partnership Agreement (CPA) contains a number of provisions giving guidance on the WTO

compatibility of EPA. Article 37.7 states that EPA negotiations would be 'as flexible as possible in establishing the duration of a sufficient transitional period, the final product coverage, taking into account sensitive sectors, and the degree of asymmetry in the timetable for dismantling tariffs'. Furthermore, in article 37.8 both sides committed to working together in the WTO to defend the arrangements reached, in particular with regard to the degree of flexibility available, whilst later agreeing in article 39.3 on the importance of flexibility in WTO rules to take into account the EAC's level of development.

Revenue Implications

Studies have shown that there will be loss of revenue to EAC country governments, thereby undermining their efforts to provide basic social services, as a result of elimination of tariffs as advocated by the EU. Below is the extent of projected liberalisation in value terms:

GOOD/PRODUCTS TO BE LIBERALIZED	EAC CET	PERIOD OF LIBERALIZATION	VALUE LIBERALIZED (US$)	% OF TRADE LIBERALIZED
Raw Materials and Capital goods	0%	By 2010	1,725,753,302	64%
Intermediate products	10%	2015 - 2022	416,830,776	16%
Finished Products	25%	2020 - 2032	65,507,218	2%
Total trade to be liberalized by EAC			2,208,091,296	82%
Total trade not to be liberalized by EAC			469,750,967	18%
Total EAC imports from EU			2,677,842,263	100%

Source: South Centre

Standstill

The standstill clause in the EPA stipulates that no new tariffs can be introduced and, once eliminated, tariffs may not be re-imposed or increased. Under the EPA, tariffs would therefore be bound at the applied rate, which is different from the WTO where applied tariff rates are often much lower than the rate at which they are bound in the WTO. A standstill obligation is included in all other EPAs negotiated with other regions, but the clauses are not identical.

Standstill provisions are not needed as a baseline for tariff liberalisation. This can instead be achieved through establishing start rates within the tariff schedules themselves (for example, choosing baseline rates or reference dates), and these need not necessarily be the rates applied when the agreement enters into force.
The European Commission initially refused to renegotiate EPA clauses such as the standstill agreed with the ESA when four of the five EAC Partner States were still part of that configuration. More recently the EC stated it is 'open to discussion' on the EAC's standstill clause in the process of working towards a full EPA. Both sides therefore formulated new standstill articles in the comprehensive EPA. They are still unfavourable to EAC countries. In Article 3, the EPA Agreement reads:

1. Except for the measures adopted according to Articles 49, 50 and 51, the Parties agree not to increase their applied customs duties for products subject to liberalisation under this Agreement.
2. In order to preserve the prospect for the wider African regional integration processes, the Parties may decide in the EAC EU EPA Council to modify the level of customs duties stipulated in Annexes II(a), II(b) and II(c), which may be applied to a product originating in the EU Party upon its importation into the EAC Partner States. The Parties shall ensure that any such modification does not result in an incompatibility of this Agreement with the requirements of Article XXIV of GATT 1994.

Export Taxes

Duties and restrictions on exports – though far less common than ordinary import duties and charges – are applied by some EAC countries on a limited number of goods, for a variety of reasons. Export taxes and restrictions are most commonly applied to 'agricultural products, fishery products, mineral and metal products, and leather, hides and skin products' While most attention is focused on export duties, restrictions can also include export licenses and quotas. The WTO does not prohibit the use of export taxes, although Article XI:1 of the GATT contains a general ban on the use of other forms of export restriction or prohibition

EAC countries opposed provisions limiting the use of export taxes as a matter of principle, and for the sake of preserving their policy space. Traditionally, one use of export taxes has been as a means of *revenue support*. While the use of export taxes has declined in the last two decades, there are a number of EAC countries – such as Burundi – which still rely on export taxes for a significant part of their government revenues. In dealing particularly with the natural resource sector, export taxes may be easier to administer by border authorities than other forms of taxation. While many countries have in the past suffered from an inadequate framework for managing wealth from minerals, forestry or other

resources, it has been argued that export taxes may be more *transparent* than alternatives – such as the granting of concessions or royalty payments. The existence of export taxes, by providing legal powers and incentives for authorities to control exports, may also assist in the *management* of those resources, for example for purposes of stabilising government revenues or *protecting the environment*: export taxes are not, however, the sole way of achieving this goal.

A more developmental use for export taxes has been to apply them as either an *industrial or export diversification policy*. Export taxes are arguably an important policy tool for countries with primary industries that are looking to add value to their raw commodities and thereby move up the commodity value chain. By taxing exports of unprocessed goods – in combination with other policies – governments can encourage producers to add value to them. By restricting opportunities to sell the unprocessed goods, the policy also has the effect of *increasing local supply of inputs* for processing and thereby *lowering prices* for them on domestic markets. In this sense export taxes can have a similar effect to subsidies, which would be allowed under an EPA, but are not always affordable in poor countries. Export taxes have furthermore been seen as a countervailing measure to tariff escalation applied in the tariff regimes of developed countries, which have the opposite effect of making imports of raw commodities more expensive in comparison with finished products.
Export taxes have also been used at various times by countries to pursue the goal of *macroeconomic stability* by influencing variables such as the exchange rate and rate of inflation, or similarly to stabilise *export earnings*. Indeed, one of the main motivations for using export taxes has been to counter the effects of *'Dutch disease'*, whereby an increase in the value of exports in a dominant sector of the economy leads to currency appreciation, with adverse effects both for exporters in other sectors and the population at large. Finally, export taxes have also been used to lower prices of essential goods, particularly food items, by restricting their export. The use of export taxes has become increasingly common as a result of the recent global 'food crisis'

Safeguards and Infant Industry Provisions

In all of the interim and full EPA texts, the issues of safeguards and infant industry protection are treated together in the chapter on 'trade defence instruments'. This is despite, arguably, some major differences between traditional safeguards – which are usually associated with dealing with temporary import surges occurring as a result of liberalisation of some other area – and the principle of infant industry protection, which relates more to a policy choice by a government to protect a certain industry for a limited period of time to enable it to achieve a degree of competitiveness.

Safeguards

The EPA contains provisions dealing with multilateral and bilateral safeguards. With regard to the former, the EPA preserves the right for the EC and EAC States to apply multilateral safeguard measures (and antidumping and countervailing duties) in accordance with the requirements of the WTO. The EC has also stated that it *may* not apply multilateral safeguards to products originating in EAC States in some of the agreements – this commitment only applies during the first five years of the EPA.

By contrast bilateral safeguards (which also include the infant industry safeguards discussed below) set out a framework under which either party may suspend its tariff liberalisation obligations in certain circumstances, namely when goods enter into the other party:

'…in such increased quantities and under such conditions as to cause or threaten to cause:

> '(a) serious injury to the domestic industry producing like or directly competitive products in the territory of the importing Party, or;
>
> (b) disturbances in a sector of the economy, particularly where these disturbances produce major social problems, or difficulties which could bring about serious deterioration in the economic situation of the importing Party, or;
>
> (c) disturbances in the markets of agricultural like or directly competitive products or mechanisms regulating those markets.'

In all cases a procedure for approving and monitoring the safeguard is envisaged, and a maximum length of time for safeguards is also stipulated. Notwithstanding the joint processes, the application of safeguards can effectively be done unilaterally. Safeguards may be applied for longer by EAC states – generally twice as long as the EU – although the EU's 'outermost regions' are treated the same as the EAC countries. The exact periods vary between EPA, with provisions for the Pacific being the longest.

Infant Industry Provisions

Questions of whether or how governments should protect infant industries are widely debated in trade theory. In the interim EPA texts several restrictions are imposed on provisions specifically dedicated to infant industries, making them in fact more akin to traditional safeguards.

Export Taxes

Export taxes are an indispensable development tool that can be used in promoting industrialization and employment creation, and in creating incentives to add value to local products rather than exporting them in their raw form. The elimination of the export taxes, coupled with the very extensive elimination of import tariffs (82%) will not only affect the economy but will also affect revenue collection in the region as import tariffs contribute a substantial amount to partner states' government revenue. Kenya has maintained the fact that while flower exports to the EU is a critical component to her revenue; negotiations should not lose sight of what this Article means in terms of giving the government policy space to promote industrial growth in other vital sectors[1].

[1] See statement by Kenyan Minister of Trade at www.seatini-uganda.org

Domestic Support in agriculture

Regarding Agriculture, the EU has rejected the discussion of its subsidies in the EPAs on grounds that this is a WTO issue. Yet developed countries including the EU have failed to live up to what was agreed on in the 2005 WTO Hong Kong Ministerial to eliminate export and trade distorting subsidies by 2013. There is also ample evidence to show that agricultural subsidies in the EU have led to the dumping of agricultural products with far reaching negative implications on Africa's agricultural production, productivity and agro-processing.

Most Favoured Nation Clause

Most Favoured Nation (MFN) clause is another contentious issue in the EPA. Under this article, the EAC is obliged to extend to the EU any more favourable treatment resulting from a preferential trade agreement with a major trading economy/country. This provision will undermine the prospects of South- South trade that the EAC countries are aspiring to promote. In addition, the clause is contrary to the spirit of the WTO's Enabling Clause that promotes Special and Differential Treatment for developing countries and South- South cooperation.

During the 4th EU-Africa summit held from 2nd-3rd April 2014 in Brussels, the two parties pledged their commitment to pursue policies that will create decent jobs and stimulate environmentally sound, inclusive, sustainable and long-term growth on both continents. In Africa, such policies are expected to promote structural transformation based on agriculture, green growth, industrialization and value addition and decent employment. These aspirations are also reflected in the post 2015 Sustainable Development Goals debate. However, these aspirations will not materialize given the direction of the EPAs.

The EPA should also have been discussed in the broader context of the post 2020 EU-EAC relationship, given the fact that the ACP-EU Cotonou Agreement which has governed the relationship between the EU and ACP countries in the areas of political dialogue, development cooperation and trade will expire in 2020 and discussion about the successor relationship between the two regions is already underway.

Non-execution clause

The issue of the 'non-execution clause' relates to the preservation of the power of the parties, in practice, the EU, to take various actions under Articles 11b, 96 and 97 of the Cotonou Agreement, even if the actions are inconsistent with the trade or trade-related commitments made under the EPA. Within the framework of the original Cotonou Agreement, these clauses allowed the EU to suspend its commitments under the Cotonou Agreement where an EAC State failed to respect human rights, democratic principles and the rule of law. This clause has been invoked following a *coup d'état* or perceived flawed electoral processes, in Fiji in 2001 and Zimbabwe in 2008, for example. In these cases, aid but not trade preferences were suspended by the EC. While economic sanctions are generally incompatible with the trade liberalisation provisions of the GATT, economic sanctions for gross human rights violations may be permitted in exceptional circumstances. The exception clauses in the EPA

preserve the rights of the parties to apply economic sanctions in at least as broad a range of circumstances as permitted under the WTO. It should be emphasised that neither side in the negotiations denies the importance of the protection of human rights or good governance.

The EAC is concerned that this provision could provide a basis for the EU to invoke unilateral trade sanctions for political violations. The EAC position since the inception of negotiations has been that the non-execution clause should not apply to EPA and should be confined to political cooperation because of the adverse impact that sanctions on one country could have on regional trade and integration, particularly if the country concerned is a key trading partner or an outlet for landlocked neighbouring countries.

Rules of Origin

In any trade agreement, the rules of origin (RoO) define the 'nationality' of goods, thereby establishing which goods qualify for preferential treatment. While identifying the origin of goods is relatively simple in the case of raw materials and commodities – which are usually 'wholly obtained' from one country – it is more difficult in the case of goods that have been manufactured using inputs sourced from more than one country. Given that most high-value exports fall increasing into the latter category, reform of the RoO was one way in which to promote the development of EAC industries, particularly in areas where they were seen as too restrictive.

A RoO regime however also needs to be balanced. On the one hand, where restrictive RoO prevent sourcing from outside the FTA partners – effectively limiting suppliers to the EU and EAC region – they can be used either to 'lock-in' existing supply chains or even to act as barriers that prevent otherwise potentially competitive industries from emerging. On the other hand, where RoO are too lax this will simply lead to trans-shipment, whereby almost-finished goods are imported into an EAC country, undergoing minimal value-adding before being exported duty-free to the EU. Finally, a RoO regime needs to be administratively simple, especially since the administrative burden of fulfilling the requirements of the regime are private sector operators. In a number of cases the value of preferential access conferred by a trade agreement has been less than the cost complying with the RoO (a situation which gets worse as the preferences are eroded by other unilateral liberalisation or other agreements, for example, in the WTO). Unless the rules are transparent and easy to comply with, and provide certainty for investors, the investments required to take advantage of them will not be forthcoming. Compliance costs are likely to be a greater issue for small producers in developing countries.

After a complicated set of negotiations on them, the rules of origin arrived at in the EPA were essentially the same as those in the Cotonou Agreement, with some improvements in the agricultural and textiles sectors (although with some potential deteriorations due to the fact that the EAC was now divided into regions and because not all countries signed EPA). Earlier on in the negotiations the EAC countries recognised the desirability of having common rules of origin across all the EPA agreements, so as to enable trade incremental value-adding – known as 'cumulation' – across different regions. As such it was envisaged that new rules would be agreed during the 'first phase' of negotiations at the all-EAC level

from 2002-04. However this was not possible due to differences between EAC regions on the issue, combined with an apparent lack of willingness on the part of the EC to make commitments during the early stages of negotiations.

The verdict

In sports, some teams specialise in winning while others specialise in losing. So it is with trade. The announcement of a "breakthrough" in the negotiations of the EPA between the EAC Partner States and the EC on behalf of the European Union (EU) has been hailed as a win-win outcome. It is not. The EC wanted market access to EAC and got it early. We back-loaded our matters and were pushed to brick wall with ultimatums and deadlines. At gun point, we capitulated.

Oduor Ong'wen is director of SEATINI-Kenya based in Nairobi. He has been a keen follower of the Economic Partnership Agreement negotiations in the past years.