Briefing Note

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Options to address contentious issues in EPA negotiations

A question of political will[1]

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1. Introduction

Eight years after the start of the negotiations of Economic Partnership Agreements (EPAs) between the Europe Union (EU) and the 77 Africa, Caribbean and Pacific (ACP) countries, only 36 ACP countries have so far concluded some type of agreement and only 25 have confirmed their commitment by signing an agreement (15 of which are Caribbean). In parallel, negotiations towards final EPAs have been progressing only very slowly, when they have not been stalled.

Paradoxically, EPAs, which should have strengthened and anchored the economic relationship of many ACP with the EU, seem to have had the opposite effect: several ACP increasingly resent the EU insistence to press for domestic reforms and ambitious commitments in the comprehensive economic and trade agreements. In spite of their development objectives, EPAs have often become an issue of continued tension between the EU and Africa. It may even have deeper negative repercussions on the EU-Africa relations, including beyond trade and economic considerations.

Despite the numerous challenges, it is high time to find a way forward to the process. The current status quo in the negotiations is not sustainable in the long term. While negotiations towards final EPAs have been dragging on for too long and have even lost momentum, finding mutually acceptable compromise has proved particularly difficult. Despite some progress achieved in some regions, overall a number of unresolved "contentious" issues still remain on the table, with little advancement so far. Indeed, parties have by now exhausted almost all technically possible solutions and alternatives.

Perhaps the EPAs should sink and be forgotten. That might be the best outcome for some countries and regions, who after all might incur more costs than derive any significant benefits from an EPA. If that is the

[1] This Briefing Note is an abridged version of ECDPM Discussion Paper 100 in Bilal S, Ramdoo I and Primack D (2010): *"Which way forward in EPA negotiations? Seeking political leadership to address bottlenecks".*

case, they should clearly indicate their intention to end or at least suspend the EPA negotiations. However, for those genuinely interested in moving forward to have a development-friendly agreement, solutions could still be found. But that would necessitate strong and clear political leadership and flexibility both from the EU and from the African and Pacific side in order to shape a solid and constructive relationship, taking a step beyond trade considerations to focus on the broader strategic agenda.

To unlock the stalemate, the following parameters could be considered.

First, the ambitions of the EPAs must match the degree of commitment and strategic priorities of those interested in moving ahead. For the EU, it would mean lowering its ambitions regarding the overall coverage of the agreement. For African and Pacific countries and regions, this would mean a narrower and sequenced agenda, focusing first on market access in goods and the development dimension, leaving aside services and a whole set of trade-related issues for future negotiations, despite the relevance of these issues for economic development. The EU accepted this principle for Economic Community of West African States (ECOWAS) in June 2009, and it should extend the same flexibility to all other interested parties.

Second, interested parties must seek politically acceptable solutions to those “contentious issues” that remain major stumbling blocks to the timely conclusion of the negotiations. Again, this will require concessions from all parties. It will also require a differentiated approach, as not all countries or regions share the same concerns. Interestingly, in most regions possible compromise technical solutions have already been identified on the main “contentious issues”. But in a bizarre twist, neither the African and Pacific countries and regions nor the EU seem too keen to capitalise on those solutions. That such compromises have been identified, however, shows that the negotiations are not as intractable as some have claimed.

Finally, while it is a shared overall objective that EPAs should promote development, it is clear that the parties have different perceptions of the development merits of some of the specific EPA provisions. A positive way forward would be to acknowledge these differences, and ultimately to respect the ACP parties’ assessments of their own development strategies.

2. Key Bottlenecks and options to move forward

2.1. Market Access on Trade in Goods

The EU has interpreted the World Trade Organization (WTO) requirements regarding the degree of liberalisation in EPAs as requiring ACP regions to liberalise at least 80 percent of their trade with the EU over a period of 15 years, given that, in return, the EU grants them duty- and quota-free market access. Many African and Pacific countries and regions, and in particular least-developed countries (LDCs), have contested this interpretation and asked for greater flexibility, in particular as it failed to take into account their low levels of development, their needs for industrialisation as well as their national sensitivities. Moreover, drastic cuts of customs duties would cause important losses in customs revenue, a major source of government revenue, therefore adding more fiscal pressures to existing weak economic situations.

African and Pacific countries and regions as well as EU officials have argued over the last 10 years about the correct interpretation of the Article XXIV of the General Agreement on Tariffs and Trade (GATT) 1994, for which no pertinent jurisprudence exist. The objective is not to arbitrarily interpret the WTO rule, but to consider what level of market opening is both politically acceptable and defensible at the WTO. According to many WTO insiders, in the current context, any free trade agreement that would cover 70 percent or more of trade over a 15-20 years period is most likely to pass this WTO test – even more so if one the parties is an LDC or vulnerable economy, as in many African and Pacific countries and regions. Possible criteria to be used could be based on the acceptability (or rather, lack of opposition) of the measure, based

on free trade agreements that have been notified at the WTO and that have never been contested, including by the EU itself[2].
Of course, as an alternative to an EPA, the EU could also provide unilateral preferences to those countries that would not find sufficient flexibility in the free trade agreement framework. This could be done either through the EU GSP system of preferences (standard GSP, GSP Plus and EBA), or through new preferences that would require a waiver. Though the EU has been opposed to the idea of a waiver, the EU itself has recently sought waivers to grant unilateral preferences to Moldova and Pakistan, due to their particularly vulnerable economic situations. The US has also obtained a waiver for its Africa Growth and Opportunity Act (AGOA), where non-reciprocal preferences are granted to selected African countries.

Similar options could be considered for the most vulnerable African or Pacific countries. Clearly the EU has refused to seek a general waiver for the whole ACP group given the cost of preference erosion that it may have but could nevertheless consider this option for special country cases or regions, based on their particular situations. Some observers have also suggested that the EU could elaborate an AGOA-type of unilateral preferences for African countries, for which a waiver should be sought[3].

Phasing out of the Community Levy

The request from the EU to some African regions (namely ECOWAS and CEMAC) to eliminate the community levy as part of the market access requirement has been another major cause of concern, given the fact that the levy is the only financial instrument available to these regions to finance the their own regional integration programmes. This issue is considered as a red line and non-negotiable for these regions as it will clearly negatively impact on their regional integration programmes.

One possible option, which is a longer-term one, would be to undertake reforms at national and regional level to find alternative ways to mobilise resources. This would necessitate accompanying measures to ensure effective implementation of the reforms, as well as possible (net) compensation of customs revenue losses in the short term. An alternative tax could be considered.

2.2. MFN Treatment resulting from future FTAs

The inclusion of a **most-favoured nation (MFN)** clause – whereby preferences granted to a large economy in the future would have be extended to the other parties of an EPA – has also been passionately debated. While this is not required or proscribed by the WTO, it is one of the most politically sensitive issues at stake.

From the ACP side, it is not acceptable as a matter of principle. ACP policy makers consider it an unacceptable constraint on their future trade agreements with third parties. The EU, however, views it as a matter of "fairness" given their generous concessions under the EPA.

Although the EU has provided DFQF under the IEPAs, in practice however, the preference margin obtained under the EPA has been relatively low. In effect, under the Cotonou Agreement, 97% of ACP products were already duty free so that the real value added of the EPAs in terms of margin of preference was only 3%. Those LDCs that have not yet agreed to an EPA are already benefiting from DFQF under the EBA, and hence would benefit from no additional preference margins under an EPA. It is therefore argued that any future trade agreement with any major trading economy may, in practice, be more attractive should they provide higher margin of preferences for African countries, including on rules of origin.

A technical compromise would consist in explicitly narrowing the scope of application of the clause and relaxing the trigger mechanisms (in terms of joint decision-making process and thresholds) for its application. Options could include:

[2] See Bilal and Ramdoo (2010). "Which Way Forward in EPA Negotiations? Seeking political leadership to address bottlenecks"; EDCPM. DP 100.
[3] See www.wto.org/english/news_e/news09_e/good_24mar09_e.htm

1. The MFN clause in the CARIFORUM EPA or the Pacific States interim EPA could be considered: signatories have committed to implement the MFN provision only after consultation, therefore removing any automatic and potentially arbitrary application of the more favourable treatment.

2. The balance of obligations and benefits between a third-country free trade agreement (FTA) and the EPA could also be considered.

3. Another option would be to increase the threshold (in terms of share of world trade) of what constitutes a major trading partner, so as to exclude more countries from the potential application of the MFN clause.

4. Including a "grand-fathering provision" that would also extend any more favourable treatment given by the EU to agreements it has concluded before the EPA to all EPA signatories. Knowing that the EU is currently engaged in a number of FTAs with many large developing countries, some of which are likely to be concluded before EPAs, this could be a "win-win" proposal that could be politically acceptable.

Despite possible technical solution, the main problem of the MFN clause, however, relates more to a question of principle, including on the negative precedent it would set. Although the probability of using such a clause is relatively slim, it appears to lower the negotiating capacity of developing countries and LDCs with other trading partners, since negotiations would start on the basis that the partner would receive no more favourable treatment that the EU.

A political solution thus needs to be found at the highest level, in view of the fact that non-flexibility on this issue may have serious negative (and undesirable) consequences on the broader economic and political relationship between the ACP and EU in general. There is also a need to measure how likely it is, in reality, many African countries would be willing to treat more favourably than the EU a large (and likely also highly competitive) country. If the MFN clause is likely to sour relationships and if the likeliness of ever using the clause is rather thin, then the EU may reconsider the need to have the clause in the agreement.

2.3. Export Taxes

Another major stumbling block to the negotiations concern the treatment of **export taxes**. The main concern of some ACP, in particular the producers and exporters of primary products,[4] is the need to maintain policy space to respond to particular economic development challenges, such as value addition, infant industry development or promotion of industrialisation in general. A position that is challenged by the EU, on the ground that, so far export taxes have not been very conclusive from a development point of view but instead have discouraged exports and have contributed to bring down the price of agricultural commodities.

The treatment of export taxes is a somewhat grey area at the WTO. Strictly speaking, WTO rules do not expressly require countries to prohibit the use of export taxes. Therefore, there is no obligation to have a clause on export restrictions in the EPA; if there is one, a simple reference to WTO rules would suffice.

Even with a binding provision on export taxes, countries could preserve some flexibility by excluding a list of products from the application of the clause.

The introduction of temporary measures under specific circumstances could also be provided for, for instance in case of specific revenue needs, or to protect an infant industry, ensure food security, protect the environment or where a country can justify industrial development needs.

[4] This includes in particular the producers and exporters of agricultural products, raw materials and other natural resources.

2.4. Bilateral safeguards

The **treatment of infant industries** has been another major cause of concern. As it currently stands in interim EPAs, it is covered under a general bilateral safeguard and therefore requires lengthy procedures before any measure could be applied to protect infant industry.

However, some regions have agreed to have stand-alone provision for the treatment of infant industries, which would have no sunset clause and which would be easier to apply than the wider bilateral safeguard measures.

It is however important to ensure that the clause is user-friendly, and not necessarily linked imports but are rather pre-emptive enough to prevent imports from affecting the infant industry.

Many African countries have proposed the inclusion of an **agricultural safeguards and food security** clause in the EPA given the importance of agriculture in many countries. However, the EU has argued that agricultural products were sufficiently covered in the general bilateral safeguards. The EU has also forcefully rejected any proposal to address the question of agricultural subsidies through the use of agricultural safeguard measures on the argument that these issues were being discussed at the WTO and therefore should not be part of bilateral negotiations. While the issue of agricultural subsidies is not likely to be resolved in the context of the EPA, technical solutions could be found on treatment of agricultural products, in the light of the FTA between EU and South Korea.

2.5. The Standstill clause/ Modification of Tariff Schedules

The question of having a **standstill clause** that prevents a country from modifying its tariff schedules is another cause of concern. The purpose of the clause is to ensure that after the entry into force of the EPAs, the parties (i) will introduce no new tariffs; (ii) will not raise existing tariffs; and (iii) once eliminated, will not be re-introduced.

It is however particularly challenging in the context of regional integration, where countries are in the process of adjusting their national tariffs to the regional common external tariffs.

Possible technical solutions have been proposed by some regions and agreed by the EU. For instance, possible options could include:

1. Application of the clause only to the products subject to liberalisation and where countries agree not raise duties above their MFN applied rates.
2. Parties could also jointly agree to allow countries to align their market access offers to their common external tariffs when the region moves toward a customs union.
3. In addition, in exceptional circumstances (to be jointly agreed), such as to meet some special development needs or in case of serious economic difficulties, the country or region could temporarily suspend the application of the schedule.

2.6. Quantitative restrictions

Interim EPAs have a provision to remove existing **quantitative restrictions** and to prevent the introduction of new such measures.

There seems to be no disagreement with the EU to adapt the clause to that of Article XI of the GATT 1994, which provides the necessary flexibility to address the concerns raised so far.

Whiles some regions do not have clear proposals so far, the ESA region has agreed to a clause that is based on GATT Article XI but does not provide for all the flexibilities of the GATT 1994. It would be appropriate to make reference to the GATT or to bring in the entire clause into the EPA to ensure policy space, as appropriate.

2.7. Non execution clause

Articles relating to the "non execution clause" are found in Cotonou Agreement (Articles 11b, 96 and 96 respectively). They provide for the possibility for parties to take sanctions and hence suspend commitments, in the case of violations of democratic or human rights principles or rules of law.

While this clause has been invoked twice[5] under the Cotonou Agreement, it is however important to note that sanctions by the EU related to the suspension of aid, but not trade preferences.

The IEPAs all have included a non-execution clause, with the express mention that countries may be subject to trade sanctions. The ACP therefore argues that such a clause should be delinked from the trade agreement and should remain within the realm of political cooperation to avoid unilateral trade sanctions for political violations. All regions have expressly rejected the inclusion of the non-execution clause in the IEPA.

3. Trade in Services: Where do we stand?

On **services**, many of these fault lines are only just beginning to emerge and the regions – both between and within – will need to determine how best to reflect their own services-related development aspirations in the envisaged texts and commitments.

It is essential to mention that unlike trade in goods, the Cotonou Agreement places no obligation on the ACP countries to negotiate trade in services (or investment). There is no existing regime to replace, no potential threat of multilateral litigation should these negotiations never come to fruition and consequently no firm deadline to meet. These points steer clear of the reasons why a country or region may *want* to negotiate services (and investment) commitments under the EPA – for which there are many – but merely states a fact regarding their required inclusion and associated timeline.

Similarly, there is no requirement that investment in non-services sectors be included.[6] The latter is subject to the interests of the negotiating parties. That being said, the inclusion of investment has been a contentious issue, with the EU promoting it and most African regions rejecting it.

Should, however, services commitments be sought under the EPA, they would be required to comply with GATS Article V (on Economic Integration Agreements).[7] Though to a lesser extent than its GATT counterpart (Article XXIV), GATS Article V also contains significant ambiguity on exactly what constitutes 'substantial sectoral coverage'. However, GATS provides for explicit flexibility when interpreting this for developing countries, such that developing country Members 'shall' be provided flexibility to open fewer sectors and type of transactions (Article XIX (2)).

[5] Zimbabwe in 2001 and Fiji in 2007.
[6] The CARIFORUM EPA does include such commitments in manufacturing, mining, agriculture and forestry.
[7] GATS Article V indicates that an agreement on services involving WTO Members must i) 'have substantial sectoral coverage' (in terms of the number of sectors, volume of trade affected and modes of supply, with no a priori exclusion of any mode of supply); and ii) provide for eliminating 'substantially all discrimination' between domestic and foreign firms in existing measures and/or the prohibition of further measures.

In this respect, it remains to be seen to how narrow or broad an interpretation of GATS Article V the EU will pursue in Africa.[8] As noted above, we do know the EU rejected Central Africa's initial offer as being unacceptable for WTO compatibility. We also know that in CARIFORUM, the (relatively) 'more developed' countries provided sectoral coverage averaging approximately 75% of all services sectors, while the less-developed countries made commitments in 65% of services sectors.

As in goods, a contentious issue already rearing itself in the services discussions relates to the EU's pursuit of an **MFN provision** that would seek to ensure it receives as good access to African markets than any other significant country might get without needing to make reciprocal (additional) concessions. While this could in theory also play to Africa's benefit, the proposed MFN (as included in the CARIFORUM EPA) is only binding for commercial presence and cross-border supply (i.e. modes 1, 2, & 3), but not for the movement of natural persons (mode 4). While the EU's claim for such treatment in goods is predicated on their offering DFQF market access for goods, this is not the case in services. Here the EU is offering only marginally greater access than set out in their revised Doha services offer.[9] Many African countries and regions have indicated that they were not ready to negotiate a services agreement and the general position of those who have shown interest has thus been to delete the provision (or at least modify it such that it only provided for consultations /negotiations with no pre-determined outcome).[10]

While couched in the context of promoting regional integration, and not substituting for it, the EU's proposed **provisions on regional preference** have raised some concerns within the ACP. Notably, the proposed provision would see any more favourable treatment and advantage that may be granted by one member of a negotiating party to the other negotiating party must also be granted to all other members of the first negotiating party. In other words, any more favourable treatment provided by one CARIFORUM State to the EC would also have to be granted to all other CARIFORUM signatory States. The above would quite clearly create a regional services arrangement that would not have existed prior. In other words, it would substitute a regional services agreement with (at least) those commitments provided to the EU.

The **temporary movement of natural persons (Mode 4)** is perhaps the most contentious subject in the services negotiating arena. Whereas importing countries are often concerned that mode 4 could enable a circumvention of immigration rules (and the political sensitivities associated with migration issues more generally), exporting countries (particularly in Africa) view mode 4 into developed countries as one of the primary areas where services liberalisation may deliver concrete development benefits.

As such, expectations at the outset of the EPA negotiations were that the EU understood the importance of mode 4 for EPAs to deliver on their development promise and would consequently pursue a relatively high level of ambition. The absence however of this ambition has been clear, with implications across the services negotiating theatre. For instance, low skilled or semi-skilled people fall outside of the chapter on the movement of natural persons. The services of many of the occupational groups that African countries might be interested in exporting to the EU also fall outside of the scope of the text. There are also no provisions for the recognition of skills of non-university trained people, nor has the EU shown any willingness to consider agreeing to a minimum numbers of people allowed to enter the EU market (which is not without precedent in a services agreement).

The use of **economic needs tests (ENTs)** is another highly contentious aspect surrounding the expected EU mode 4 commitments. The is due to the fact that the EU's use of ENTs effectively provides member states a potentially discriminatory window in which they can refuse market access on the basis of some undefined 'market situation', which may (or may not) include 'the number of, and impact on, existing suppliers'.

[8] For example, will they seek 'accession-like' commitments, where recent WTO developing country members have had to accept extremely wide-ranging commitments (i.e. in over 90 out of 166 sub-sectors), far beyond those required of many original WTO members.
[9] See TN/S/O/EEC/Rev.1
[10] A further suggestion has been that more favourable treatment only needs to be provided to the other party to the EPA if the third party in question has not overall provided greater market access than the EPA party seeking MFN treatment.

4. How to move forward? A question of political will

Moving forward with the EPA process is now a question of political will since so far, all possible technical discussions have been explored and yet, have failed to deliver mutually satisfactory results. The EU is currently reassessing its options, but it has yet to outline a clear approach on the way forward, based on concrete new proposals. In the meantime, ACP countries and regions have to individually reassess their ambition and degree of commitment to the EPA process. The ACP and the AU fora, among others, offer them an opportunity to consider a common platform on the way forward on EPAs.

4.1. Focus on WTO-compatible options reflecting the ACP diversity and regional integration dynamics

To progress in the EPA negotiations, notably on the contentious issues, it is crucial for the parties concerned to reach an agreement that both reflects the development ambitions of the ACP and that can be jointly defended at the WTO. This will require a careful assessment and strong political guidance.

Recognising the possible difference of opinions on the development merits of some of the contentious provisions in an EPA, the parties' primary focus should be on ensuring that the potential agreement is compatible with WTO rules and principles. At the same time, policy makers should also aim to maintain the overarching objective of longer-term sustainable development.

While a coherent approach on EPAs must be preserved across ACP/African countries and regions, it is important to recognise the diversity of situations and interests across the ACP. Various options can be followed in different regions or countries, based on the driving strategic objectives and specific development needs of each region or country.

That said, one of the overarching objectives of the EPA process is the strengthening of regional integration in the ACP. While the EPA process cannot be a substitute for an endogenous regional agenda by ACP groupings, the conclusion of EPAs should not undermine the regional integration process. A key concern should thus be to construct an EPA that will strengthen regional integration. It is thus important to conduct a reality check, and assess which type of agreement is most likely to effectively support the regional integration objective, where possible.

The EU has the means to flex its muscles to speed up the conclusion of final EPAs. Setting firm deadlines for the removal of EPA preferences to those countries or regions that do not comply with their commitment to sign, ratify and implement EPAs that have been concluded could be a decisive move. However, the imposition of too-tight deadlines with little flexibility from the EU could seriously disrupt regional integration processes if a particular region is split on how to move forward. It could also have detrimental effects on development if a deadline forces some countries or regions to endorse an EPA agenda that does not match their domestic development strategies. Effective implementation might also become illusionary. It may also sour relations with the EU, with long lasting negative consequences.

A more flexible approach – one that acknowledges concerns expressed during the negotiations, even at the price of reduced ambitions – may prove a more effective way forward.[11] Recognising that some ACP countries may not yet be ready or willing to conclude an EPA would also be crucial.

Indeed, contentious issues in the EPA will remain at the core of the negotiations for the final EPA. While many non-IEPA signatories have expressed the wish to be part of the final EPA, one of their conditions, however, related to the need to resolve the contentious issues, while at the same time addressing outstanding technical issues.

[11] See Bilal S. and Lui D. 2009. "Contentious Issues in the EPAs: Potential Flexibility in the negotiations", ECDPM Discussion Paper 89, Maastricht, The Netherlands: European Centre for Development Policy Management. www.ecdpm.org/dp89

The state of advancement of the negotiations on the contentious issues is varied. Some issues have been resolved relatively easily at technical level, others are more sensitive and require clear political guidance. These include fundamental issues of the degree of market access liberalisation expected from negotiating countries (such as SAT, transition period, community levies, export taxes, safeguards, standstill and non-execution clause), in particular LDCs, which is the main determinant of the deal, and the inclusion of an MFN clause, which may influence the negotiating power of African and Pacific countries in future trade agreements. As discussed in this paper, several options can be identified to address some of these key contentious issues.

4.2. Politics and broad strategic ambitions should drive the way forward

To find a way out of this impasse, the EU must propose concrete options to African and Pacific countries. Similarly, it is high time for the ACP countries and regions to assess whether they want to conclude a final EPA – if so, then they must decide by when and under what conditions. Reaching an agreement will require concessions from both sides.

To start, all parties must recognise that the EPA process is first and foremost a political issue, not a technical one that should be left to trade negotiators. Political leaders should thus guide possible technical remedies by negotiators, notably on contentious issues.

The EPAs have been presented as advanced and far-reaching instruments for binding trade and development. A failure to deliver on these development promises would be a serious setback to the EU trade and development agenda, including in the context of the Doha Round.

At the same time, it is important to acknowledge the political repercussions that EPAs have on the relations between the EU and the ACP, notably Africa. The EPA process is too serious of a matter to be left to trade people alone. A more strategic vision towards the ACP/Africa – EU relationship is desperately required.

ECDPM Briefing Notes

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