SADC’s Trade Agenda at the EU-Africa Summit - SAIIA

Perhaps the most important item on the economic agenda is the completion of a range of free trade agreements between Europe and various African blocs, including a Southern African Development Community (SADC) group that incorporates South Africa. These Economic Partnership Agreements (or EPAs) will redefine Africa’s trading relationship with Europe, but have been bogged down for a decade amidst controversial negotiations that have strained relations between the two continents.

In a forthcoming publication, Christopher Wood looks at what issues SADC should focus on at the EU-Africa Summit, and where there is room for compromise.

The SADC EPA: The Way forward [working paper]

By Christopher Wood

The ten-year negotiations on free trade agreements between the European Union and groups from Africa, the Caribbean and the Pacific (ACP) will come to an end on October 1, this year. It remains uncertain if all parties will have completed their respective regional Economic Partnership Agreement, or EPA.

However, on that day in October, regardless of the state of the deal, the EU will put an end to the difficult and at time acrimonious negotiations. The stakes remain high. The EPAs are meant to replace the long-standing Cotonou agreement, which gave ACP countries duty-free access to the wealthy European market. This access provided a competitive edge that will disappear if no agreement is reached.

In SADC, Botswana, Namibia and Swaziland would lose duty free access to the profitable EU market; while South Africa and Angola, Mozambique and Lesotho would maintain access under the Trade, Development and Cooperation Agreement and Everything But Arms agreement respectively.

Thankfully, the negotiations on a SADC EPA are close to completion, but a range of the most difficult issues have been left until last, and must now be overcome. Four issues have consistently stood in the way of the completion of a deal. They are export taxes, the Most Favored Nation (MFN) clause, agricultural safeguards, and rules of origin. Each barrier is analysed below, with a brief overview of the issue, why it remains contentious, and a possible route to resolution.

Export Taxes

What is the issue?
Exports taxes are, as the name suggests, duties placed on exports. Export taxes are usually applied to commodities, in an attempt to divert supply of the good away from the export market and into the domestic market, thus driving the price up internationally and down locally. While they have sometimes been used to generate government revenue or improve food security, the primary use of export tariffs is to encourage local processing and beneficiation of basic goods.

The EU insists on a ban on all export taxes for South Africa and Angola, and a ban on export taxes for other SADC EPA countries in all but a few extreme cases.

Why is it contentious?
The EU sees export taxes as fundamentally unfair. Export taxes can drive up prices, harming the importer – in this case the EU – while relatively wealthy countries like South Africa benefit at their expense. The EU sees Africa as a vital strategic source of basic commodities, and is concerned about anything that can interrupt their supply of cheap raw materials. African countries see export taxes as a means to move up the value chain, and to break the colonial relationship in which they sell unprocessed goods to the rich world, and then buy back processed goods, making a loss in the process. They see the development of domestic processing as way to industrialise, creating jobs and moving the continent up the value chain.

What is the way forward?
Simply put, the EU should abandon its objection to export taxes, for three reasons. First, export taxes are highly unlikely to create large harms for the EU market. Export taxes impose costs on both the exporter and the importer. Exporters (African firms) have to pay an additional tax to export their goods. Importers (the EU) face extra costs because exporters raise prices to account for the tax.

Crucially, the mechanism by which the EU would suffer is thus rising prices. But prices for the commodities the EU cares about are set on the world market. Unless a country has a huge proportion of the global market for that commodity, they will not have the requisite market power to change global prices significantly.

In most cases, African countries do not have the necessary market power to effect global prices. This means that overwhelmingly it is local firms who will bear the cost of export taxes, because they will have to accept both the tax and fixed world prices. Given this cost, there is a natural disincentive against the use of export taxes, and they will almost certainly be used sparingly, and only in cases in which they can do so much good that this harm is offset.

Secondly, banning export taxes is an intrusion on the sovereign decision-making of African states. Yes, export taxes are complicated and many opposing voices need to be considered. But these voices should be heard in the context of a domestic political process that is accountable and balanced. Europe insists on similar sovereignty for the industrial support it provides under the Common Agricultural Policy, and it is hypocritical to ignore these demands in the case of Africa. Domestic policymaking processes will make better decisions and will more closely reflect the views of those exporters who are most effected by the costs of export taxes.

Finally, export taxes have become an incredibly contentious issue poisoning Africa-EU relations. They are seen as representing Europe's attempt to maintain old colonial value chains, and of ignoring the development interests of the continent. The idea that coercing African states to accept these conditions will assure Europe's resource security is misguided. Even if Europe succeeds in banning export taxes, this victory will come at a further loss of ground in the battle for the hearts and minds of African states. Europe has fallen behind the likes of China in tapping into Africa's natural wealth for precisely this reason. Ultimately, a strained relationship will cost Europe more than export taxes ever will.

The Most Favored Nation (MFN) Clause

What is the issue?
A most favoured nation or MFN clause requires that if any party in the EPA signs a trade deal with a third country and offers better market access, then this improved access must also be given to the other EPA country. This only comes into effect if the third party is a large economy which, given the current threshold, includes developing countries like Brazil, India and China.

Why is it contentious?
African states see the MFN clause as undermining South-South cooperation, and stifling their ability to expand their network of free trade agreements in the future. The EU argues that it would be unfair for African states to offer market access that they claim is too sensitive to give to the EU, particularly considering that the EU is offering generous duty-free quota-free access to their markets.

What is the way forward?
It seems largely inconceivable that the MFN clause would be activated for a deal with developing countries anytime soon. SACU negotiations with India and Mercosur have been stuck for years and are unlikely to leap forward. The idea of a free trade deal with China would seem suicidal for any hopes of industrialisation. The only major concern in the near term is the potential for negotiations on a reciprocal deal with the United States, particularly if the American Congress decides not to renew the African Growth and Opportunity Act in its current form. Matching US and EU market access would limit the capacity for controlled liberalisation, in which states open to some partners to spur competition, but limit the entry of all imports to protect local producers.

A compromise could be found in changing the nature of the clause. As it currently stands, if tariffs are reduced for a third party on any item excluded from the EPA, then improved access on this item must also be given to the EU. This is problematic because trade deals are a process of give and take, and opening up on a sensitive product might be a means to win a better deal. This doesn't mean the product isn't sensitive, or that the industry won't be threatened by the double whammy of market access for the EU and US, it simply demonstrates the uniqueness of the bargaining process in every trade negotiation.

An MFN clause isn't necessarily bad, but it should be changed from this current line-by-line calibration. An alternative would be an MFN clause that requires African states to match the percentage of tariff lines liberalised in any other deal. The EPAs are likely to liberalise 80% of overall tariffs. If African states give the United States 85%, it would not be particularly damaging to extend Europe an extra 5%, so long as African states have the ability to manage the tariff lines on which the concessions happen. This compromise might still limit and strain future trade negotiations, but it would be a less damaging concession that could help movement past this difficult issue.

Agricultural Safeguards

What is the issue?
Safeguards are tariffs that activate in the case of an inflow of exports that could threaten the survival of a local industry. Safeguards have been agreed in the context of the EPA, and are quite generous, with more flexible activation clauses than those found in the WTO. However, activating a safeguard requires a lengthly process of consultation, which might be unsuitable in some cases,

particularly in agriculture.

Why is it contentious?
The EU feels that it has given enough leeway on safeguards, and that agricultural restrictions are unnecessary. African states argue that current safeguards would be too slow to implement, requiring a 30-day notification period, after which the safeguards could still be rejected. They argue that protecting local agricultural industries requires more immediate action, and thus there is need for a specific agricultural safeguard.

What is the way forward?
Whether or not a separate safeguard measure is necessary, safeguards should be calibrated to work for the agricultural sector. It must be remembered that even if tariffs are liberalised in the EPAs, the EU does not engage in free trade in the area of agriculture. Europe continues to provide 57,5 billion Euros (in 2013) in support to agricultural firms, while also maintaining 539 special agricultural safeguards at the WTO, with only Switzerland-Liechtenstein and Norway holding more.

Despite this, consultation on the activation of safeguards is fair and reasonable. However the burden of proof should be inverted. Instead of safeguards requiring notification and approval, they should come into force immediately and stay in force until such time as they are proven to be unnecessary. Doing so provides for the consultation the EU requires, while assuring the measures are strong enough to adequately protect firms operating in the highly distorted agricultural market.

Rules of Origin

What is the issue?
Rules of origin are complicated legal procedures that track where products originate from. They aim to prevent third countries from taking advantage of free trade deals by, for example, producing goods in Brazil but sending them to Europe via Angola. Rules of origin usually require either that a good entirely originates in a given country, or that the country adds significant value to it.

Why is it contentious?
Rules of origin are not particularly contentious at this point in the negotiation. There is a good deal on rules of origin on the table. Crucially, this deal includes substantial leeway for cumulation. Cumulation is an exception to usual rules of origin that is offered to other members of the same free trade agreement, and to neighbouring or closely related countries. In the case of the EPAs, countries may cumulate their rules of origin with any ACP countries, or with neighbouring states. This assures that the connections between countries in the region can be maintained, and allows for the development of value chains flowing across multiple regional economies and onwards to Europe.

What is the way forward?
While a deal is on the table, work should still be done on rules of origin because of how complicated it will be to implement the deal. Rules of origin are very technical, requiring reams of paperwork, issued by well-equipped and well-trained customs agencies, and overseen by specialist lawyers. The legal requirements of rules of origin are often so costly that they discourage exporters from building beneficial relationships with compatible manufacturers in regions where cumulation is possible. The EPA can assist in overcoming these barriers in three ways.

First, finance should be made available to up-skill and streamline local customs agencies. Second, one stop offices to assist with paperwork should be established in major trade hubs, following a similar model to the US Trade Hubs developed under AGOA. Finally, additional trade finance should be made available for first time exporters. The export process tends to get marginally less expensive the more companies engage in it, as they gain the skills and knowledge to efficiently work through the system. Adequate finance for new exporters will help overcome the deterrent of high initial costs, and provide the learning-by-doing needed to build an efficient system of rules of origin.

Conclusion

Ultimately, the EPA will only make a meaningful contribution if it can succeed outside the negotiating room, when it is placed in the hands of the domestic regulators who must put it into practice. Successful implementation will only be possible if those politicians and civil servants believe the deal is beneficial. Strategic concessions on these final issues holds the key to building the necessary political will to give life to the deal, and to strengthen the vital EU-Africa partnership.